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Investment Age

Insurance assets targeted

Managers aim for piece of $1 trillion

By Curtis Vostl

Faced with a flat or declining pension fund market, money managers are battling for market share in the management of assets of small insurance companies, estimated to represent as much as $1 trillion.

The 10 leading money managers who have targeted insurance company assets report they already are handling $30.1 billion.

The market has increased during the past decade, analysts say, as insurers — who used to invest the assets themselves — have become more sensitive to investment performance, and money managers and consultants have stepped up their efforts in this area because of a flattening pension market.

"The (insurance) market practically defies quantification," said Henry Blagden, manager of insurance investment services at the New York office of Brown Brothers Harriman & Co., which manages $1.6 billion for insurance companies.

"It's a niche discovered by more and more managers as they discover the pension field isn't growing as fast," he said.

Dave Kirk, senior vice president for David L. Babson & Co., Cambridge, Mass., said managers also are attracted to insurance companies because insurers tend to be longer-term employers of money managers.

"Investment managers want to be long-term investors, but with the emphasis on quarterly performance, many pension sponsors don't permit them to be," Mr. Kirk said. Babson manages $300 million in insurance company assets.

Most analysts agree an insurer with $1 billion or less in assets is most likely to use the services of a money manager. Those with more than $1 billion, they say, often manage the assets themselves.

"Even companies over $1 billion have holes they have to fill," said Stephen Dillenburg, vice president at Washington Square Capital Inc., Minneapolis, which manages $7.2 billion in insurance company assets.

Just how much money from how many insurance companies is available to money managers is debatable.

A 1985-'86 research report by Aetna Financial Services Inc., Hartford, Conn., indicated there were almost 4,800 domestic life and property and casualty insurers with less than $1

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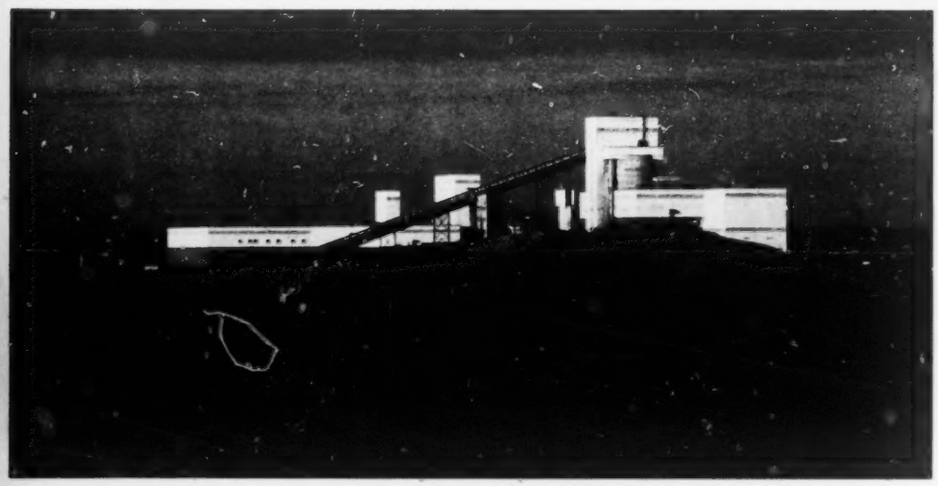
Leading managers of insurance company assets

	($ billions)
Scudder Insurance Asset	10
Washington Square Advisors	7.2
Stein Rowe & Farnham	3
Asset Allocation Mgmt.	3
Chancellor Capital Mgmt.	2.1
Brown Brothers Harriman	1.6
CIC Asset Mgmt.	1.4
Aetna	1.1
MIMLIC	0.4
David L. Babson & Co.	0.3



INCO Ltd., which operates this mill in Sudbury, Ontario, has proposed a $1 billion recapitalization plan that may force investors to accept a $10 dividend with a poison pill plan.

INCO debate rages

Controversial plan includes poison pill

By Marcia Parker

INCO Ltd. executives are stepping up 11th hour appeals to institutional investors in the United States and Canada, many of whom oppose the Canadian nickel producer's controversial $1 billion recapitalization, $10 dividend and poison pill.

Institutional investors say they don't want to be "bribed and coerced" into voting Dec. 9 for Canada's first poison pill by supporting the recap and dividend.

The institutional vote is key in the outcome of one of the most contentious debates in Canadian business circles. Institutions own about 70% of INCO. About 50% are U.S. institutions, 40% Canadian and 10% foreign institutions.

In recent days, INCO executives, led by Chairman and Chief Executive Officer Donald J. Phillips, have been meeting with institutional investors to lay out the company's arguments in support of the recap and shareholder rights plan.

It is too early to tell how they will vote, but an informal survey of a dozen major U.S. and

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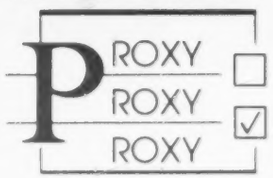
Takeover law topic of proxy season battle

By Marcia Parker



For the first time, activist institutional investors are sponsoring shareholder resolutions for the upcoming proxy season that call on The Boeing Co., Kimberly-Clark Corp., Lockheed Corp. and Ford Motor Co. to opt out of Delaware's takeover law.

In other firsts, Wells Fargo & Co., which is incorporated in Delaware, is being asked to leave and reincorporate in its home state of California, and Dow Chemical Corp. is being asked to put any "golden parachutes" to a shareholder vote.

The 1989 season promises to be another headline-grabber, as institutional investors expand the scope of their corporate governance-oriented campaigns to win shareholder support for resolutions aimed at loosening the near-monopoly Delaware has on incorporation, putting poison pills to a shareholder vote, and instituting confidential voting.

An equally aggressive campaign is planned on social issues such as corporations doing business with South Africa and labor practices in North Ireland (*see related story, page 3*).

The key players again will include the $44 billion California Public Employees' Retirement System, the $15.6 billion State of Wisconsin Investment Board, the $33.6 billion New York City Retirement Systems, the $66 billion Teachers Insurance and Annuity Association — College Retirement Equities Fund and the $23.7 billion California State Teachers Retirement System. Some unions also will be active, including the United Brotherhood of Carpenters and Joiners of America, the United Mine Workers of America, and the Amalgamated Clothing and Textile Workers Union.

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LATE NEWS

Fund shifts $6 billion in-house

SACRAMENTO, Calif. — The $25 billion California State Teachers' Retirement System is moving in-house a $6 billion fixed-income portfolio that has been managed by Mitchell Hutchins Institutional Investors Inc., formerly Manufacturers Hanover Investment Corp., since 1983.

The fund hired Manufacturers Hanover to run the assets after the California Legislature in 1982 ordered the then-$10 billion in California Teachers' assets separated from the then-$17 billion California Public Employees' Retirement System. Manufacturers Hanover was to run the fixed-income assets until the fund could hire sufficient staff to manage the assets.

In July 1987, after New York-based Mitchell Hutchins had acquired Manufacturers Hanover, fund officials asked the firm to transform the portfolio to an index fund, after which the fund's staff would run the assets.

Thomas E. Flanigan, chief investment officer of the California Teachers' system, said the switch to internal management is part of a long-term plan and not a reflection of Mitchell Hutchins' performance.

Arizona plans allocation review

PHOENIX, Ariz. — The $6.6 billion Arizona State Retirement System hired Wyatt Asset Services Inc. to do an asset allocation study to help fund executives better understand the relationship of the system's assets and liabilities, according to Doug Lemon, investment officer.

Mr. Lemon said it is too early to say if the results would lead to an allocation change. The system's current asset mix — 42.3% fixed income, 40.61% common stocks, 16.1% in cash and the remainder in mortgages and international — was the result of an asset allocation study completed a few years back.

Mr. Lemon said the system is doing the study, which is expected to take two to three months to complete, in part as a way to prepare for the anticipated adoption of accounting regulations by the Government Accounting Standards Board.

Election bolsters Canadian funds

TORONTO — The re-election of Canadian Prime Minister Brian Mulroney's Progressive Conservative Party will enhance prospects of Canadian pension funds being permitted to double their foreign investments.

In addition, passage of a U.S.-Canadian trade pact, which looks certain given the election results, might boost direct cross-border investment by U.S. and Canadian companies.

Virginia Atkin, a partner at Keith P. Ambachtsheer & Associates Inc., a Toronto consultant, said she thinks the victory by Mr. Mulroney's party should help ease the foreign investment regulations.

Keith Ambachtsheer, partner at Ambachtsheer & Associates, and others have been lobbying the Canadian Department of Finance to loosen foreign investment rules. They want Canadian funds to be allowed to double their foreign holdings (to 20% from 10% currently), by adding two percentage points a year during a five-year period.

Michael McKay, vice president of GBF Buck Consultants Ltd., Toronto, thinks passage of the U.S.-Canadian trade pact is likely to have little effect on investment management and pension fund assets. "The only thing is managers will be looking for companies that will exploit the U.S. market more but they're probably buying those companies already," he said.

PBGC set to appeal in LTV case

NEW YORK — The Pension Benefit Guaranty Corp. filed a brief Nov. 22 in 2nd U.S. Circuit Court of Appeals, giving the grounds for its appeal of the court's ruling that the agency could not force The LTV Corp., Dallas, to restore three pension plans.

The brief says the PBGC believes the court erred in ruling LTV's follow-on plans did not violate the pension insurance program and, therefore, couldn't be used as a reason for restoration. The follow-on plans are costing LTV $100 million a year and are crafted so employees are earning and receiving benefits as though no termination had occurred, but the company shifted $2 billion in unfunded pension liabilities from the terminated plans to the PBGC, a spokeswoman said.

LTV's brief is due in the court Dec. 21. A reply by the PBGC is due Jan. 4, and oral arguments likely will begin in early January.

Exec moves to investment firm

SAN DIEGO — Jim Meehan, manager of financial services at San Diego Gas & Electric Co. for the past two years, is leaving to become vice president-fixed income client servicing at Delaware Investment Advisers, Philadelphia.

Mr. Meehan was responsible for pension assets, cash management, corporate financing and nuclear decommissioning funding. The utility has about $300 million in pension assets. His replacement is Charles McMonagle, who has been supervisor of financings and investments at the utility for two years.

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L.A. plan trustees dismayed at loan

By Steve Hemmerick

LOS ANGELES — Trustees of the Los Angeles County Retirement Association are questioning the decision by county financial executives to borrow $100 million from two Japanese institutions to help reduce the $8.5 billion pension fund's $1.5 billion unfunded liability.

The loan is a 10-year, taxable private placement with Nippon Life Insurance Co. and the Long Term Credit Bank of Japan Ltd., both in Tokyo. Because the county's first obligation is to the pension fund, the loan will be senior to all other county debt. The senior status, coupled with the fact the proceeds will be used to pay down pension debt, enabled the county to obtain a 9.59% borrowing rate, said Sandra Tracey, county treasurer-tax collector.

"What is really happening is that the county is finding a means of lessening its costs, paying an obligation that it has to our retirement system," she said.

The agreement, signed Nov. 16, includes a currency-swap agreement that enables the county to receive its proceeds in dollars while the lenders are repaid in yen.

Pension fund trustees expressed anger over their lack of involvement in a transaction in which fund assets played such a critical role. Norman Johnson, chairman of the trustees, asked the county's chief administrative officer, Richard B. Dixon, to meet Nov. 23 with trustees to answer their questions.

Earlier, Mr. Dixon said the county will invest the $100 million in high-yield securities, such as savings and loan association securities, and use the profits to reduce the pension fund's unfunded liability.

But two trustees — Robert Hermann and Simon Russin — said they were told the county would use the proceeds to make normal plan contributions, not to reduce the unfunded liability. "What is so outrageous about this move is they are not paying off any unfunded liability, but they are borrowing money to make a normal $30 million monthly contribution to the pension fund and risking all this borrowed m[illegible]y," Mr. Russin said.

Ms. Tracey said it has not been decided yet where the money will be invested, adding it could be a loan to a sovereign government or in triple, double or single A corporate bonds. The county would not buy junk bonds, she said.

"If we felt there was any potential risk, we wouldn't go into it. Our intent is that we will be making sound investments," said Ms. Tracey.

Retirement association executives, however, were angered by the announcement of the private placement and might try to stop the transaction.

Mr. Hermann said the decision by Mr. Dixon and Ms. Tracey to exclude the investment board members from the decision to borrow the money was "patronizing."

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Fund invests in realty package

By Steve Hemmerick

The $1.3 billion Southern California Edison Co. pension fund invested $10 million in a commingled pool that will buy industrial properties that eventually will be packaged and resold to larger investors.

So far, the utility is the only investor in the closed-end fund, managed by AMB Real Estate Advisors, the new subsidiary of AMB Investments Inc., San Francisco. The pool — Western Properties Fund I — has a target of $100 million, and is AMB's first major push into the pension area.

The commingled pool also will invest in small retail properties, priced between $3 million and $15 million, said T. Robert Burke, a principal with AMB. The retail properties won't be packaged.

AMB officials expect to pay substantially less for the pool's properties, with initial capitalization rates possibly as high as 9% to 9.5%, 50 to 100 basis points over what other funds are paying, and substantially higher than cap rates on regional malls, which they said now are in the 5% to 6% range.

Mr. Burke said larger investors don't have the time to scout the many small bulk warehouse properties in the Western states, properties already familiar to AMB.

Although property transactions between and among commingled funds are done, managers usually don't make such deals part of their strategy.

"If you buy an office building, you can put a lot of money out just buying one building. The idea is if you can put together a package of industrial properties, they will generally be more valuable than the individual properties themselves," said Rick Yamamoto, supervisor of pension investment with Southern California Edison.

In many cases, insurance companies have sold properties out of their commingled funds to other tax-exempt investors, but the simple sale of one fund's property to another doesn't mean there is a premium paid, said Hamid R. Moghadam, a principal with AMB.

He said it is a myth that people will pay a premium for a portfolio of mixed-bag properties spread across a large part of the country. "I think the buyers make a better deal than the seller," Mr. Moghadam said.

AMB, on the other hand, is assembling an "integrated" package of smaller properties. "There is so much demand for medium-size, integrated portfolios of properties that people will pay a premium to buy them," Mr. Moghadam said.

"If you do buy a bunch of $3 million and $5 million industrial buildings in the same market, and you have $15 million or $20 million of them to sell, and they are a logical group, there are a lot of buyers out there that will buy a $15 million or $20 million deal, who wouldn't spend the time to look at a $3 million to $5 million deal."

AMB executives will invest the assets in Los Angeles, San Francisco, San Diego, Seattle, Denver, Phoenix, Salt Lake City and Orange County, Calif.

AMB is one of five real estate managers Southern California Edison hired. The others, and the amount allocated to each, are: Equitable Real Estate Investment Management Inc., Atlanta, $20 million to the Prime Property Fund; JMB Institutional Realty Corp., Chicago, $6 million to Group Trust II and $4 million to Group Trust IV; TCW Realty Advisors, Los Angeles, $10 million to Fund V; and LaSalle Advisors Ltd., Chicago, $10 million to Street Fund.

The latest hires bring Southern California Edison's real estate investments to $70 million, or about 5% of its assets. The fund previously had invested $10 million in PMRealty Advisors Inc.'s PMR I, a closed-end fund. ■

Rex Sinquefield will retain control of DFA along with David Booth.

DFA buys founder out, will sell 25%

By Barry B. Burr

Dimensional Fund Advisors Inc. agreed to buy back the nearly one-third stake of a founder in the money management company for $8.5 million, paving the way for it to agree to resell 25% of its outstanding shares to units of Kemper Financial Cos., Chicago, and Schroders PLC, London.

Schroder Capital Management International, New York, is an original venture-capital investor in DFA, already holding options on 15,750 shares, or 15% of the company on a fully diluted basis.

DFA hasn't developed any marketing or investment strategies with its new shareholders, according to Rex A. Sinquefield, DFA co-chairman and chief investment officer.

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Surge in buy-outs is trickling down into GIC activity

By Fred Williams

For better or worse, the leveraged buy-out fever sweeping Wall Street will have a definite effect on insurance company investment returns and, more particularly, on the $75 billion guaranteed investment contract business.

GIC specialists have mixed feelings about the long-term effect of the leveraging of corporate balance sheets, but few doubt the credit quality of insurers and the fixed-income securities they purchase to back GICs will come under closer examination by investors, regulators and rating agencies.

"Sagging prices and higher yields (in the bond market) indicate weakening credit worthiness in the eyes of industrial bond buyers like insurance companies," said Sharon Morell, senior contract negotiator at Morley Capital Management Inc., a GIC management firm in Lake Oswego, Ore.

"As a result, insurance firms may be forced to buy higher-quality, lower-yielding investments such as Treasury and government agency securities instead of purchasing industrials. Carriers that continue to buy corporate issues may choose shorter, less risky maturities only. Both strategies will, most likely, cause GIC yield spreads to narrow."

Peter Bowles, president of Fiduciary Capital Management Inc., Woodbury, Conn., however, believes leveraged buy-outs, which are financed largely through the use of high-yield bonds and often result in a downgrading of other corporate debt, are "part of the evolution" in the financial markets and may prove positive for both insurance companies and GIC buyers.

"As bond prices drop, yields increase in junk bonds, which will put pressure on the offerers of high-quality bonds to offer better yields," Mr. Bowles said. "Investors will see the relative risks between the two will decrease, along with spreads between the two. If there is more demand for low-quality bonds, it will force high-quality bonds to increase yields to attract buyers. It will provide more supply of investments to supply the growing demand for GICs."

The overall results, he said, should be a relative increase in GIC rates.

One consequence, however, is the increased use of junk bonds in insurance company investment portfolios, a trend some believe has gone too far.

"Some carriers will have to look at some things they may have in the past turned up their noses at and begin to make additional use of junk bonds, maybe not in large quantities — as long as they

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Junk bonds as a percentage of insurer bond portfolios

	1987	1986
Executive Life	65.80%	64.28%
Northwestern National	43.07	45.40
Mutual Life of New York	22.06	18.09
Equitable Life Assurance	20.83	13.73
Southwestern Life	18.68	13.87
New England Mutual	16.43	10.02
Phoenix Mutual	16.15	15.12
Prudential	15.42	11.20
John Hancock	13.63	10.24
Principal Mutual	12.73	8.04
Pacific Mutual	12.26	9.99
Mutual Benefit	10.65	5.25
Home Life	10.24	5.93
Connecticut General	9.89	8.66
Minnesota Mutual	9.67	5.51
State Mutual	9.56	6.35
Aetna Life	8.94	8.05
Penn Mutual	8.19	8.08
Connecticut Mutual	8.17	5.65
Northwestern Mutual	8.14	6.60
Massachusetts Mutual	6.66	5.22
Travelers	6.32	4.85
Transamerica Occidental	5.79	1.48
Sun Life of America	5.68	4.42
Aetna Life and Annuity	5.54	4.47
Guardian Life	5.21	4.90
Transamerica Life & Annuity	5.16	1.12
IDS Life	4.49	3.97
Provident Life & Accident	4.20	4.64
New York Life	3.88	4.46
Nationwide	3.79	4.12
Metropolitan Life	3.41	4.15
Commonwealth	3.17	2.37
State Farm	1.99	2.62
Peoples Security	1.88	1.94
Provident National	1.84	1.58
Peer Group Average	**11.38**	**9.23**
Peer Group Median	**8.18**	**5.58**

Source: Moody's Investors Service, New York

GDP weighting gains followers

By Joel Chernoff

A few U.S. tax-exempt investors are turning to international indexes weighted by the gross domestic product instead of traditional market-capitalization weighted benchmarks.

While proponents of the GDP-weighted index say it more adequately reflects the wealth of nations, opponents say it is primarily a way of justifying lower exposure to Japan. In addition, some maintain GDP-weighted index funds have triple the turnover of market-cap indexes and contain hidden trading costs that sharply increase their cost.

"Neither the GDP or market-cap index is perfect," said Jan Harding, a vice president at Frank Russell Co., Tacoma, Wash. But flaws inherent in the GDP approach outweigh its benefits, she added.

With Japan at 63.4% of the Morgan Stanley Capital International Europe Australia Far East Index, pension fund executives have been fretting about their exposure to the island nation — whether they believe they are overexposed through passive vehicles or are trying to justify the typical underweighting held by their active international equity managers.

Under a GDP-weighted approach, an index fund or benchmark uses the same countries and stocks contained in the EAFE or other international index, but weights the country allocation by each nation's economic strength. Thus, Japan is only 33.4% of the GDP-weighted EAFE, while West Germany is increased to 15.85% from 4.7%.

In the past year, the $9 billion GTE Corp. pension fund, Stamford, Conn., the $6.4 billion State of Connecticut Trust Funds, Hartford, and the $1.7 billion Yale University endowment fund, New Haven, Conn., have adopted GDP-weighted benchmarks, and sometimes, GDP-weighted portfolios.

Advocates of GDP-weighted indexes say there are numerous factors in favor of the approach.

"One of the excuses for (GDP weighting) is that it's just a way to reduce the Japan weight. But I think there's more to it than that," said Lyle Davis, managing director and chief investment officer of Boston International Advisors Inc., Boston, a leading proponent of GDP-weighted index funds.

Mr. Davis said use of a GDP-weighted index reflects the value of corporate earnings within a country, instead of using both earnings and the price-earnings ratio. "It's sort of a historical accident that some markets have well-developed stock markets and others don't," he said.

Frank McDermott, assistant treasurer-investments at the State of Connecticut fund, said the decision to invest in a GDP-weighted index fund hinges on how officials look at equity markets.

"We invest in stocks because we want to participate in the growth of economies, not the size of stock markets. We thought this was a more rational approach," he said.

On Jan. 1, the Connecticut fund made an initial $50 million investment in a GDP-weighted index fund run by Boston International; the portfolio since has grown to $150 million.

Connecticut's portfolio with Boston International also is free of South Africa-related stocks, which reduces its Japanese exposure to 30.5%. It returned 9.7% in the first three quarters, compared with 10.6% for Boston International's GDP-weighted portfolio and 11.1% for the EAFE (with gross dividends reinvested).

Mr. McDermott and others also cited the automatic "buy low, sell high" aspect of a GDP-weighted index. While GDP weightings shift only marginally, market performance will tend to either buoy or depress individual countries' representation within the index, thus forcing regular rebalancings.

Proponents say adoption of a GDP weighting provides better diversification and is more stable over time than a traditional market-cap index. While the percentage of Japan in the EAFE has jumped nearly fivefold from 14% in 1970, it has remained relatively stable within a GDP-weighted index, increasing to 33.4% from 21%.

Volatility of market-cap indexes can cause problems. "If the Japanese market drops 40%, you would have to sell Japanese stocks into a weak market to get proper market capitalization," said John Carroll, president of GTE Investment Management Corp.

This fall, GTE adopted a GDP-weighted benchmark for its active international equity managers because it was more reflective of countries' economies, Mr. Carroll said. In addition, it provided a 50% currency hedge to reduce risk and cause its managers to focus on currency risk, he said.

Meanwhile, long-term performance is virtually the same as with a market-cap approach. In the 14-year

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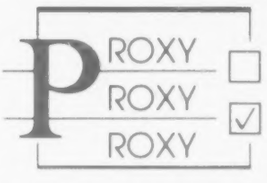
Social issues remain

S. Africa, N. Ireland on '89 proxy agenda

By Trudy Ring



Corporations will face about the same number of South Africa-related shareholder resolutions in 1989 as they did in 1988, while the number of resolutions on Northern Ireland will be greater.

So far, 90 resolutions on South Africa have been submitted to be voted upon in the coming proxy season, according to the Investor Responsibility Research Center, Washington. In 1988, shareholders submitted 109 South Africa-related resolutions, but voted on 87 because 13 were withdrawn following negotiations between the company and the sponsor of the resolution.

Twenty-two questions on Northern Ireland are scheduled for a vote next year, while 16 were submitted and voted on this year.

These numbers indicate shareholder activism on social issues is not abating, said Carolyn Mathiasen, director of the IRRC's social issues service. "All the publicly held companies that are in South Africa are getting resolutions," she said.

Most call for withdrawal of operations from South Africa, and many ask the companies to sever sales and licensing agreements.

But at least 16 companies that do not have a physical presence in South Africa have received resolutions asking them to cut other ties to that nation. These include IBM Corp., Xerox Corp., Westinghouse Electric Corp. and General Motors Corp.

Other resolutions ask companies to end sales to the South African police and military or to adopt the Statement of Principles (formerly the Sullivan Principles), an equal employment and social responsibility code.

Most of the Northern Ireland resolutions ask the companies to adopt the MacBride Principles, a code calling for equal opportunity for Catholics in the workplace. U.S. companies operating in Northern Ireland have shied away from endorsing the principles because of a concern they constitute reverse discrimination and therefore would violate British law.

It is unlikely shareholders would call for companies to leave Northern Ireland, Ms. Mathiasen said. "A major concern is the fact that unemployment is so high. The last thing (shareholders) want to see is for a major U.S. employer to leave Northern Ireland."

The list of shareholders filing resolutions on South Africa and Northern Ireland includes many of the prominent names of past proxy seasons: the New York City Employees' Retirement System, the Interfaith Center on Corporate Responsibility, the Teachers Insurance and Annuity Association — College Retirement Equities Fund, New York State and Local Retirement Systems, New York State Teachers' Retirement System, General Board of Pensions of the United Methodist Church and State of Wisconsin Investment Board.

Among the new sponsors are the states of Connecticut and Minnesota, where legislatures have mandated activism on Northern Ireland.

Connecticut's law calls for the $6.3 billion State of Connecticut Trust Funds to divest, by May 1990, the stock of any company operating in Northern Ireland that has not adopted the MacBride Principles, said Marvellen Andersen, investment officer-social compliance.

The Connecticut funds hold stock in nine of these companies and are sponsoring or co-sponsoring resolutions at NYNEX Corp., Teleflex Inc., VF Corp., and Son-

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OPINION

It's the ultimate LBO

In launching a leveraged buy-out bid for the federal government, Kohlberg, Kravis, Roberts & Co. has gone too far.

Last week, KKR offered a $1.25 trillion package for the government. The offer is composed of $750 billion in senior debt, $500 billion in subordinated debt, $20 million in equities and assorted S&H Green Stamps.

"The U.S. has just been begging to be raided," said a KKR official, noting the country is undervalued as evidenced by the level at which its "stock," the dollar, is trading.

Pension funds should withhold their commitments from the KKR LBO pool if the firm insists on pursuing this hostile takeover attempt. They will have several grounds on which to do so.

First, many have prohibitions against hostile takeovers in their contracts with KKR. Second, KKR, if successful, might have to end the tax exemption of pension contributions and investment earnings to raise revenue to service the junk bonds issued to finance the takeover.

On the other side of the coin, however, public funds might have a lot to gain through a takeover.

Through ownership, they could force the federal government to cut its ties with South Africa, thus effectively creating the foreign policy they now seek to do at the local level.

They also could restore the sovereignty of the states, which steadily has been eroded since Marbury vs Madison and the Civil War, as well as restore the tax-exempt status of industrial development bonds, allowing K mart to continue its conquest of strip malls.

Corporate pension investors, however, might run into other difficulties, especially if their parent companies are later approached to buy parts of the government that will have to be sold off to pay down the debt used to finance the deal. That could cause the funds to be in violation of ERISA's conflict of interests rules.

General Electric, for example, might be asked to acquire the Department of Defense (minus the Pentagon building, which reportedly will be offered to JMB Institutional Realty). A consortium of United Technologies and General Dynamics also has been mentioned as a possible bidder for the department.

Exxon and Mobil are expected to be among the high bidders for the Department of Energy, while Avon might be interested in acquiring the Food & Drug Administration.

The biggest prize, of course, is the Federal Reserve Board. Citicorp is believed to be interested, but a consortium of Japanese and U.S. institutions also is said to be mounting a bid.

While the Industrial Bank of Japan apparently has committed to buy a good part of the junk bond financing necessary for the deal, domestic institutions are reportedly wary.

They say the government is highly leveraged already, and are skeptical of its ability to carry the amount of junk debt necessary to finance the deal. They note the government loaded up with debt during the past eight years precisely because it felt vulnerable to a bid from KKR or Forstmann Little & Co., and might have taken on enough to be invulnerable.

Just hours after the announcement of the bid, Moody's lowered the rating of U.S. government debt, prompting speculation Treasury bondholders will sue.

Further, although KKR may be able to sell government departments to pay down some of the debt, investors remain skeptical the firm can either improve government efficiency or increase revenue enough to carry the additional debt burden. They point out that eight years of the Reagan administration made barely a dent on government inefficiency.

It would be ironic if the government used a Pac Man defense against KKR and launched a takeover bid for the LBO specialists.

OTHER VIEWS

By G.A. David Gray

A "Master of the Universe" telephones an investment manager, offering $5 million Caveat Emptor Inc. 8.625% debentures due in 28 years.

The salesman explains, at a yield of 10%, the debentures provide 100 basis points more yield than U.S. Treasury securities of the same maturity. For a strong, A credit, this is "an exceptionally attractive" spread.

The Master also argues Caveat Emptor is almost immune to "event risk" because it would require $15 billion or more to be taken private and that "our analyst says nothing that big will ever be taken over."

While the investment manager long has been leery of industrial debt issues because of event risk, he buys $3 million par value of debentures at a price of 87¼. The purchase represents 3.5% of his portfolio.

At the same time, in the Master's mergers and acquisition department, a coterie of investment bankers meets with senior management to plan a Caveat Emptor leveraged buy-out. The price — $18 billion. Excitement mounts. The bankers' fees will top $200 million. Management will get rich. The buy-out price of the stock will exceed 90. (It closed at 59 last week.) Equity portfolio managers will be ecstatic; their clients, pleased.

The next day, as headlines scream out news of the deal, the bond manager's stomach sinks. The two major rating agencies announce a credit review, which likely will reduce Caveat Emptor's debt rating to double B or lower — less than investment grade.

The bond manager calls the Master of the Universe howling. The Master responds: "Those 'expletive deleteds' upstairs did the whole deal and no one told us. In fact my trader still has the other $2 million you didn't buy. How do you think he feels?"

Noting the bonds are quoted at 74½, the Master says, "That's a yield of 11.75%, or 190 basis points over Treasuries."

"I don't give a darn about the yield over Treasuries," the manager responds. "I've just lost 13 points, or $390,000 of my client's money. On a $75 million portfolio, that's 52 basis points of performance. For my account, my performance this year will be fourth quartile. That wrecks our marketing efforts for next year. In addition, my bonus will be zilch!"

Shortly afterwards, the agencies reduce the rating to B, citing the inordinate amount of Caveat Emptor debt that will hit the market. They stress they expect the bonds to be "money" good. The now speculative-grade issue, however, must be sold by the bond manager to comply with client investment guidelines.

Once again, the manager calls the Master, and asks, "What's your bid for the $3 million Emptors you sold me?"

"We can't bid," replies the Master. "As an underwriter of the new Emptor junk paper, we are restricted from bidding. In fact, most of Street is in the new Emptor deal. So none can bid.

"We will be happy to take an order on an agency basis and see what we can do for you. However, ever since those damn rating agencies downgraded the issue, there are more sellers than buyers. In fact, the issue looks like it has widened another 50 basis points against Treasuries since the downgrade. Treasuries, in fact, have done really well during this rally."

The manager sells his Caveat Emptor bonds for a total loss of $480,000 on his "investment." Because his performance was lower fourth quartile, having underperformed the market by 64 basis points, he subsequently was fired.

Questions: Will bond portfolio managers ever learn? If they do, will the bond market be closed permanently to investment-grade industrial companies?

Should underwriters be prohibited from offering a company's bonds if they are participating in discussions that will change materially the structure of the balance sheet and, therefore, the bond rating? If not, should underwriters be legally bound to buy back from investors — at investors' cost — issues sold by them that subsequently were downgraded because of the underwriter's role in revamping the balance sheet of the borrower?

Should corporate bond issues carry provisions that will enable investors to "put" bonds back to the issuer at par whenever the borrower's rating declines by one full rating category? If the borrower's securities are investment grade when an issue is created, why should the lender suffer if the quality of the borrower's financial statements declines or is deliberately wrecked?

P.S. According to Thomas Wolfe, a "Master of the Universe" is a bond salesman. He got it wrong, didn't he? ■

Mr. Gray is vice president and manager of structured fixed income at The Boston Co., Boston.

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PIPER

Value gives equity leaders the edge

By Curtis Vosti

Value was the key word in the investment strategies of the top performing equity funds in the third-quarter Pensions & Investments' Performance Evaluation Report, with hedging giving the leading fund its edge.

The leader among the 314 pooled equity funds of banks and insurance companies in the PIPER universe for the quarter ended Sept. 30 was the $7 million hedged equity fund of Gary Wheaton Bank of Chicago. It had a return of 5.3%, compared with the Standard & Poor's 500 Stock Index's 0.3%, and the median fund's 0.1%.

The Gary Wheaton fund sells S&P 100 stock options against the fund, which is a value-oriented portfolio, according to Doug Eyles, vice president and manager of the trust division.

"The hedging ... that was the thing that helped our performance," he said.

The average 25 stocks in the portfolio are picked through a disciplined screen of stocks with more than $200 million capitalization and stressing financial strength and dividends. The screened stocks then are ranked according to their price-earnings ratio. Those that fall in the lower 40% of the p/e ranking are candidates to be bought, while those that ranked in the top 60% are candidates to be sold, Mr. Eyles said.

The stocks typically are held for two to three years.

Sizable holdings include **RJR Nabisco Inc., American General Corp., May Department Stores Co., K mart Corp.** and **Philip Morris Cos. Inc.,** he said.

The second-ranked fund for the quarter — returning 5.19% — was the equity fund of United States National Bank of Galveston, Texas. The $42 million fund targets a rate of return greater than the rate of inflation during a three- to five-year market cycle, according to Freddie Meier, senior vice president and trust officer.

He said the fund is value-oriented, looking for stocks with above-average dividends and low p/es.

The fund has lowered its cash position to 20% in the third quarter from 40% at the time of the 1987 market crash. The 100 stocks in the fund are held until they reach a target price, and then are sold piecemeal, Mr. Meier said. "We do not chase markets," he said.

The fund is invested about 34% in financial stocks and 17% in consumer staples such as tobacco companies, he said. Large holdings include the **Federal National Mortgage Association** and **The Kroger Co.**

Coming in third was the equity fund of the National Bank of Commerce, Nashville, Tenn. It returned 4.5% for the quarter.

Myron Mall, president of the bank's subsidiary, Commerce Capital Management Inc., Nashville, said the $12 million fund is "in the true sense, a value-oriented" fund that typically holds its stocks for three to five years.

The fund buys stocks after they go through a number of screens, looking for low price-cash flow and low price-book ratios.

"We make projections on future revenue streams based on past results and future economic assumptions," Mr. Mall said.

Large holdings include **Best Products Co. Inc., Interco Inc., Hospital Corp. of America** and **Rhodes Inc.**

The top ranking fund for the year ended Sept. 30 was the $448 million institutional equity fund of First Chicago Investment Advisors, Chicago, returning 16.5%, compared with the S&P 500's −12.4% and the median fund's −10.3%.

The fund, which finished in the top decile for the three- and five-year periods and in the top quartile for the quarter, stresses long-term value, according to Bob Moore, director of research.

He said the fund started lowering its 50% cash position immediately after Oct. 19, 1987, and was in the 10% to 15% range by the end of the third quarter.

The stocks are picked on "straight value," he said, based on the current value of cash flows. "A lot of five-yards-and-a-cloud-of-dust type of stuff," he said of the number crunching. The horizons tend to be three years or more.

Current holdings include **MCI**

Continued on page 23

Pooled equity funds
(periods ended Sept. 30, 1988)

	Quarter	1 yr.	3 yr.	5 yr.	10 yr.
Highest return	5.26%	16.45%	28.75%	23.97%	22.30%
First quartile	1.22	−6.96	18.28	14.68	15.94
Median	0.12	−10.30	16.57	12.95	14.75
Third quartile	−1.09	−13.83	14.62	11.07	13.24
Lowest return	−9.85	−41.55	4.03	4.80	7.81
S&P 500	**0.34**	**−12.39**	**18.32**	**14.72**	**15.42**

Fixed income funds
(periods ended Sept. 30, 1988)

	Quarter	1 yr.	3 yr.	5 yr.	10 yr.
Highest return	5.87%	19.43%	15.24%	16.13	13.42%
First quartile	2.08	13.07	10.96	12.40	11.02
Median	1.80	11.64	10.04	11.57	10.23
Third quartile	1.58	10.10	9.03	10.77	9.66
Lowest return	0.39	2.42	2.55	7.52	6.46
Shearson G/C	**1.87**	**12.77**	**10.67**	**12.27**	**10.72**

Riskier techniques help in fixed income

By Carol Wiley

A high-yield fund and an arbitrage fund were the best performing bond funds for the quarter and the year ended Sept. 30, according to the Pensions & Investments' Performance Evaluation Report.

The report ranks 285 commingled fixed-income funds run by banks and insurance companies.

During the quarter, the median fund returned 1.8%, just shy of the Shearson Lehman Hutton Government/Corporate Bond Index at 1.87%.

The median fund lagged the index for all other time periods, as well. The median fund returned 11.5% for the year ended Sept. 30, compared with the index's 12.8%, a compound annualized 10.4% for three years against the index's 10.7%; 11.6% for five years vs 12.3%; and, for 10 years, 10.2% vs 10.7%. (All returns for periods longer than one year are compound annualized.)

The best performer for the quarter was the $5.5 million High-Yield Return fund managed by PM Capital Management, Newport Beach, Calif., for its parent, Pacific Financial Cos., also of Newport Beach. The fund returned 5.97%. For the year, it returned 14.2%.

The fund looks for quality in the high-yield market and is actively managed, said Nancy Kelly, operations manager-institutional sales.

"We look for fallen angels on the mend," Ms. Kelly said. The portfolio contains a number of collateralized mortgage obligations and a "nominal amount" of bond futures, she said.

Ms. Kelly would not divulge the names of the fund's corporate holdings.

A fund run by California First Bank, San Diego, ranked second for the quarter, with a return of 3.91%, a bond fund managed by Life of Virginia/Aon Advisors Inc., Richmond, ranked third, with 3.8% return.

Kenneth Sanders, chief investment officer at California First, did not return phone calls by press time.

The $150 million Collective Fund F run by Centerre Trust Co., St. Louis, ranked first for the year with a 19.4% return.

Economic analysis has led Centerre to run long in bonds during the past year because it believes the economy is in a disinflationary period, said Robert Franklin, chief investment officer for fixed income.

Investment tactics include arbitrage, although Mr. Franklin

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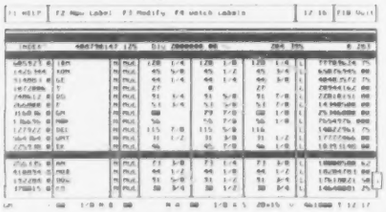

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Top quartile commingled fixed-income funds

3-month returns

	%
Pacific Financial (Hyr.), Calif.	5.9
California First Bank	3.9
Life of Virginia	3.8
Wellington Trust (Emerg.), Mass.	3.5
General American (SA 9), Mo.	3.5
Greeley Nat'l, Colo.	3.3
Centerre Trust, Mo.	3.2
Trust Services of America, Calif.	3.1
Nat'l City Cleveland	3.1
Liberty Nat'l, Okla.	3.0
Bank of America, Calif.	2.8
Second Nat'l Bank, Ohio	2.8
Pacific Mutual, Calif.	2.8
Trust Co. of the West (High yield)	2.8
John Hancock, Mass.	2.8
Union Labor Life (SA B), D.C.	2.8
Delaware Trust	2.7
Cullen Bank, Texas	2.7
First Interstate of California	2.6
First Variable Life, Ark.	2.6
Beverly Bank, Ill.	2.6
Marine Midland, N.Y.	2.5
Fidelity Bank, Pa.	2.5
The New England, Mass.	2.5
First N.H. Investment (B)	2.5
The Principal, Iowa	2.5
Transamerica (SA T-2), Calif.	2.5
Sovran Bank (Inst.), Va.	2.5
New York Life (SA 4)	2.5
Mutual of New York (Private)	2.4
Security Pacific, Calif.	2.4
Capital Trust, Ore.	2.4
First Chicago	2.4
Chase Manhattan (Long), N.Y.	2.4
Nat'l Bank of Detroit	2.3
Mutual of New York (Public)	2.3
First Kentucky Trust	2.3
First Variable Life, Ark.	2.3
Wellington Trust (High yield), Mass.	2.3
Bankers Trust (A), N.Y.	2.3
Travelers (SA D), Conn.	2.3
Trustmark Nat'l, Miss.	2.3
NCNB Texas (Long)	2.3
Mercantile Bank, Mo.	2.3
Aetna Life (SA 76), Conn.	2.2
Connecticut Nat'l	2.2
Massachusetts Mutual	2.2
CIGNA Corp. (Active), Conn.	2.2
First of Kenosha (CT4002), Wis.	2.2
Frost Nat'l, Texas	2.2
First Bank Milwaukee	2.2
Chase Investors (Index), N.Y.	2.2
IAA Trust (B), Ill.	2.2
First of Maryland	2.2
Irving Trust, N.Y.	2.2
Hawaiian Trust (Defensive)	2.2
Citytrust (E3), Conn.	2.2
First Asset Mgmt., Minn.	2.2
Core States Investment, Pa.	2.2
Bank One, Indianapolis	2.1
Midlantic Nat'l, N.J.	2.1
First Tennessee Memphis	2.1
Ameritrust, Ohio	2.1
Jefferson Trust, Ill.	2.1
American Security, D.C.	2.1
Signet Trust (Stable), Va.	2.1
Security Nat'l (II), W. Va.	2.1
Connecticut Nat'l Bank (Inter.)	2.1
Morgan Guaranty, N.Y.	2.1
Wellington Trust (G/C), Mass.	2.1
Metropolitan Life (SA 41), N.Y.	2.1
Maryland Nat'l	2.1
First Asset Mgmt., Minn.	2.1
First Wisconsin Asset	2.1
Key Trust Co. of Alaska	2.1
First Nat'l Mercantile (B), Mo.	2.1
Shearson Lehman G/C Index	**1.9**

1-year returns

	%
Centerre Trust, Mo.	19.4
Beverly Bank, Ill.	18.6
General American (SA 9), Mo.	17.5
First Variable Life, Ark.	16.7
Delaware Trust	16.7
NCNB Texas (Long)	16.4
The Principal, Iowa	16.1
California First	15.9
Capital Trust, Ore.	15.8
IAA Trust (B), Ill.	15.8
State Street Bank, Mass.	15.6
Mercantile Bank, Mo.	15.5
Union Labor Life (SA B), D.C.	15.4
Trust Services of America, Calif.	15.2
Chase Manhattan (Long), N.Y.	15.2
Transamerica Life (SA T-2), Calif.	15.2
First Interstate of California	15.1
Morgan Guaranty, N.Y.	14.8
American Security, D.C.	14.8
Maryland Nat'l	14.7
Comerica Bank, Mich.	14.6
First Chicago	14.6
First Kentucky Trust	14.5
Northern Trust, Ill.	14.5
Wellington Trust (G/C), Mass.	14.5
Nat'l Bank of Detroit	14.4
Pacific Mutual, Calif.	14.4
Midlantic Nat'l, N.J.	14.4
Frost Nat'l, Texas	14.3
Trust Co. of the West (High yield)	14.3
Citytrust (E3), Conn.	14.2
Pacific Financial (Hyr.), Calif.	14.2
Seafirst Bank, Wash.	14.2
Seattle First Nat'l	14.2
Mutual of New York (Public)	14.1
Nat'l City Cleveland, Ohio	14.1
Core States Investment, Pa.	14.1
Connecticut Nat'l	14.0
Second Nat'l Bank, Ohio	14.0
Bankers Trust (A), N.Y.	14.0
First Nat'l Mercantile (B), Mo.	14.0
The New England, Mass.	14.0
CIGNA Corp. (Active), Conn.	14.0
Fidelity Bank, Pa.	13.8
Travelers (SA D), Conn.	13.8
First Wachovia, N.C.	13.8
Chase Investors (Index), N.Y.	13.8
First Chicago (Dollar)	13.7
The Phoenix (Mgd.), Conn.	13.7
Equitable Capital (5), N.Y.	13.7
Connecticut Nat'l (Inter.)	13.7
Sovran Bank (Inst.), Va.	13.7
Hawaiian Trust	13.7
Bank of America, Calif.	13.6
First of Kenosha (CT4002), Wis.	13.6
Chancellor (Bondshift), N.Y.	13.6
Hamilton Bank, Pa.	13.5
First Trust, Colo.	13.5
Metropolitan Life (SA 41), N.Y.	13.5
First Wisconsin Trust (Index)	13.4
Harris Trust, Ill.	13.4
First Asset Mgmt., Minn.	13.4
First Asset Mgmt., Minn.	13.3
Exchange Nat'l Bank, Ill.	13.3
John Hancock, Mass.	13.3
First Bank Milwaukee	13.2
Chicago Title & Trust, Ill.	13.2
Aetna Life (SA 76), Conn.	13.1
New York Life (SA 4)	13.1
Shearson Lehman G/C Index	**12.8**

3-year returns

	%
United of Denver	15.2
Delaware Trust	15.2
Equitable Capital (5), N.Y.	14.6
Transamerica Life (SA T-2), Calif.	14.5
Beverly Bank, Ill.	13.8
Centerre Trust, Mo.	13.7
Sunburst Bank, Miss.	13.7
Chase Manhattan (Long), N.Y.	13.6
First Variable Life, Ark.	13.5
IAA Trust (B), Ill.	12.9
Connecticut Nat'l	12.7
General American (SA 9), Mo.	12.7
Wellington Trust (Emerg.), Mass.	12.6
Sanwa Bank (C), Calif.	12.6
The Principal, Iowa	12.5
Colonial American Nat'l, Va.	12.5
LaSalle Nat'l (Long), Ill.	12.4
Metropolitan Life (SA 41), N.Y.	12.3
Trust Services of America, Calif.	12.3
Pacific Mutual, Calif.	12.2
Union Labor Life (SA B), D.C.	12.2
Travelers (SA P), Conn.	12.2
Fidelity Bank, Pa.	12.1
First Kentucky Trust	12.1
First Chicago	12.1
Sovran Bank (Inst.), Va.	12.0
Harris Trust, Ill.	12.0
First Interstate of Arizona	12.0
American Security, D.C.	12.0
John Hancock, Mass.	12.0
Northern Trust, Ill.	11.9
Chase Manhattan (A), N.Y.	11.9
Mutual of New York (Private)	11.9
Core States Investment, Pa.	11.8
CIGNA Corp. (Active), Conn.	11.7
Manufacturers Life (B), Ontario	11.7
Morgan Guaranty, N.Y.	11.7
Shawmut Bank, Mass.	11.6
Society Nat'l, Ohio	11.6
Bankers Trust (A), N.Y.	11.6
Nat'l Bank of Commerce, Neb.	11.6
NCNB Texas (Long)	11.6
Bank of America, Calif.	11.5
First Nat'l Mercantile (B), Mo.	11.5
Connecticut Nat'l Bank (Inter.)	11.5
Colorado Nat'l Bank	11.5
First Wachovia, N.C.	11.4
The Phoenix (Mgd.), Conn.	11.4
First Interstate of California	11.3
Comerica Bank, Mich.	11.3
First Wisconsin Trust (Index)	11.3
Chicago Title & Trust	11.3
Wellington Trust (G/C), Mass.	11.2
Exchange Nat'l Bank, Ill.	11.2
Continental Illinois	11.1
Life of Virginia	11.1

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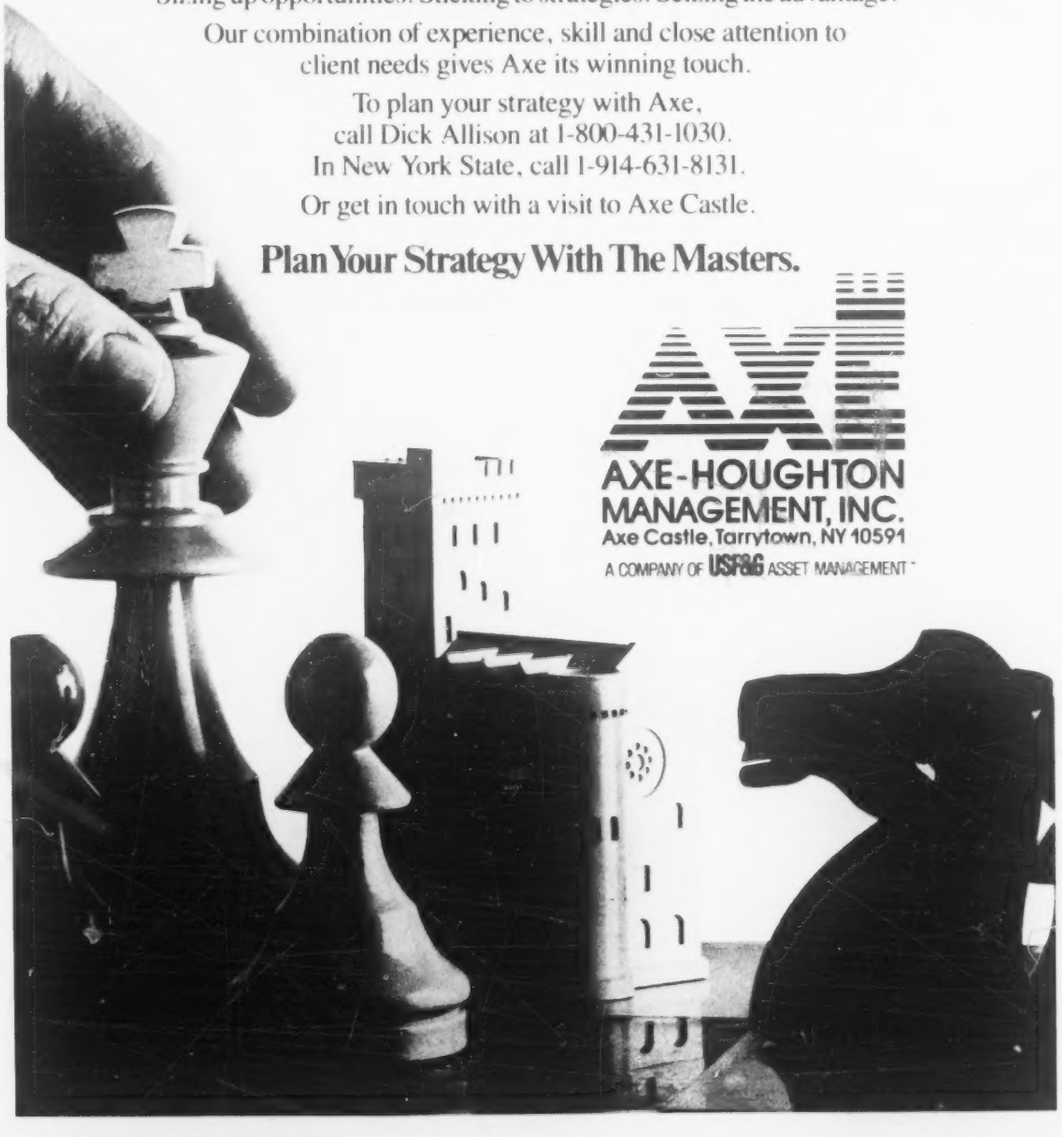

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1-year returns

Over $100 million

	%
Centerre Trust, Mo	19.4
The Principal, Iowa	16.1
Mercantile Bank, Mo	15.5
Chase Manhattan (Long), N.Y	15.2
Transamerica Life (SA T-2)	15.2
American Security, D.C	14.8
First Chicago	14.6
First Kentucky Trust	14.5
Nat'l Bank of Detroit	14.4
Pacific Mutual, Calif	14.4

$50 million to $100 million

	%
Trust Services of America	15.2
Comerica Bank, Mich	14.6
Northern Trust, Ill	14.5
Midlantic Nat'l, N.J	14.4
Mutual of New York (Public)	14.1
Bankers Trust (A), N.Y	14.0
First Wisconsin Trust (Index)	13.4
Life of Virginia	12.8
Sun Bank, Fla	12.7
Banc One Asset, Ohio	12.6

$10 million to $50 million

	%
Beverly Bank, Ill	18.6
Delaware Trust	16.7
NCNB Texas (Long)	16.4
California First Bank	15.9
Capital Trust, Ore	15.8
IAA Trust (B), Ill	15.8
Union Labor Life (SA B), D.C	15.4
First Interstate of California	15.1
Wellington Trust (G.C), Mass	14.5
Frost Nat'l, Texas	14.3

Under $10 million

	%
General American (SA 9), Mo	17.5
First Variable Life, Ark	16.7
Morgan Guaranty, N.Y	14.8
Maryland Nat'l	14.7
Pacific Financial (Hyr.), Calif	14.2
Connecticut Nat'l Bank	14.0
Second Nat'l Bank, Ohio	14.0
First of Kenosha (CT4002)	13.6
Hamilton Bank, Pa	13.5
First Trust, Colo	13.5

10-year returns

Over $100 million

	%
Sovran Bank (Inst.), Va	13.1
Centerre Trust, Mo	12.6
Pacific Mutual, Calif	12.5
American Security, D.C	12.4
Texas Commerce (Active)	12.3
First Kentucky Trust	12.1
Hibernia Nat'l, La	11.7
Bank of New England, Mass	11.5
Northern Trust (Inter.), Ill	11.4
Mercantile Bank, Mo	11.3
John Hancock, Mass	11.3

$50 million to $100 million

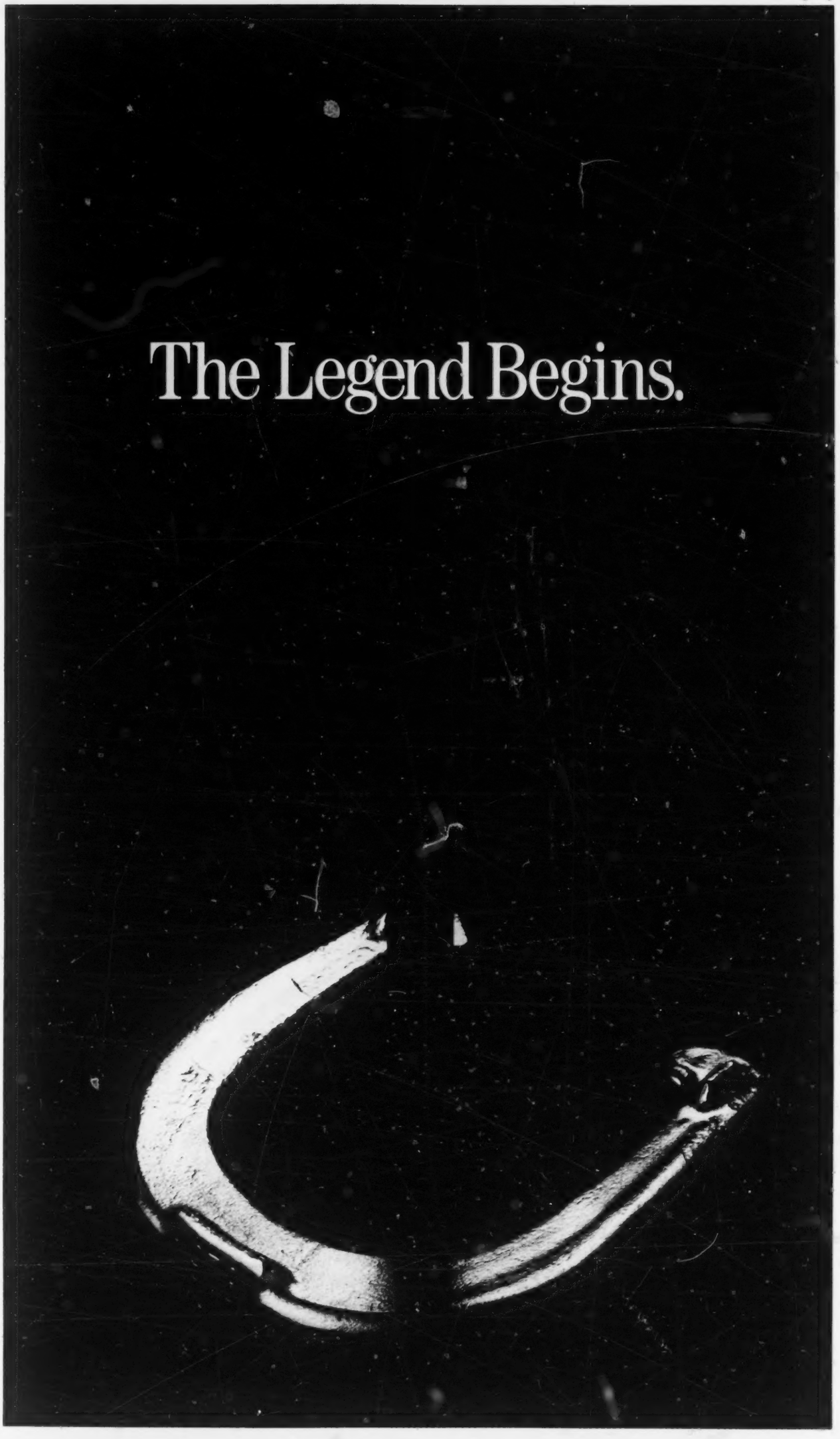
	%
Life of Virginia	12.0
First Jersey Nat'l, N.J	11.6
Bankers Trust (B), N.Y	11.4
Manufacturers Detroit	11.3
Bankers Trust (A), N.Y	11.3
Trust Services of America	10.9
Massachusetts Mutual	10.8
Northern Trust, Ill	10.7
First Fidelity (Inter.), N.J	10.6
Citizens Fidelity (F), Ky	10.5

$10 million to $50 million

	%
United of Denver	13.4
Beverly Bank, Ill	13.3
Seafirst Bank, Wash	12.4
Fidelity Bank, Pa	12.3
Sanwa Bank (C), Calif	11.9
First Interstate of California	11.9
First Interstate of Arizona	11.7
First Wisconsin Asset	11.7
Cullen Bank, Texas	11.5
IAA Trust (B), Ill	11.4

Under $10 million

	%
Morgan Guaranty, N.Y	11.7
Central Fidelity, Va	11.6
Connecticut Nat'l Bank	11.6
Sovran Bank/Central South	11.5
Second Nat'l Bank, Ohio	11.3
Colonial American Nat'l, Va	11.2
Oregon Bank	10.9
Exchange Nat'l Bank, Ill	10.6
Firstier Bank Lincoln, Neb	10.4
Associated Manitowoc (High)	10.4



PIPER

Massachusetts Mutual	11.1
MTrust, Texas	11.0
First City Nat'l Houston	11.0
Chancellor Capital, N.Y.	11.0
Liberty Nat'l, Ky.	11.0
Nat'l Bank of Detroit	11.0
First Alabama Bank	11.0
First of Omaha (C), Neb.	11.0
General American (SA 8), Mo.	11.0
Shearson Lehman G/C Index	**10.7**

5-year returns

	%
United of Denver	16.1
Delaware Trust	15.9
Transamerica Life (SA T-2), Calif.	15.3
Equitable Capital (5), N.Y.	15.0
IAA Trust (B), Ill.	14.9
Sunburst Bank, Miss.	14.8
Beverly Bank, Ill.	14.6
Centerre Trust, Mo.	14.5
The Principal, Iowa	14.2
Trust Services of America, Calif.	14.1
Connecticut Nat'l	13.9
First Variable Life, Ark.	13.8
Pacific Mutual, Calif.	13.7
First Interstate of Arizona	13.7
Life of Virginia	13.6
Mutual of New York (Private)	13.6
First Kentucky Trust	13.6
Colonial American Nat'l, Va.	13.6
Travelers (SA P), Conn.	13.5
General American (SA 9), Mo.	13.5
Sanwa Bank (C), Calif.	13.5
Sovran Bank (Inst.), Va.	13.5
American Security, D.C.	13.4
First Chicago	13.4
John Hancock, Mass.	13.4
Morgan Guaranty, N.Y.	13.4
Colorado Nat'l Bank	13.3
Northern Trust, Ill.	13.2
First Interstate of California	13.1
Society Nat'l, Ohio	13.1
Harris Trust, Ill.	13.0
California First Bank	13.0
Central Fidelity (Mgd.), Va.	13.0
First Chicago (Dollar)	12.9
First Alabama Bank	12.9
Wellington Trust (Emerg.), Mass.	12.9
First Wachovia, N.C.	12.8
First Variable Life (H.Q.), Ark.	12.8
Nat'l Bank of Commerce, Neb.	12.8
Core States Investment, Pa.	12.7
Exchange Nat'l Bank, Ill.	12.7
Bankers Trust (A), N.Y.	12.7
Fidelity Bank, Pa.	12.7
Seattle First Nat'l	12.7
Seafirst Bank, Wash.	12.7
First of Omaha (C), Neb.)	12.6
Continental Illinois	12.6
Chancellor Capital, N.Y.	12.6
Metropolitan Life (SA 41), N.Y.	12.6
Connecticut Nat'l Bank (Inter.)	12.6
NCNB Texas (Long)	12.5
Union Labor Life (SA B), D.C.	12.5
Aetna life (SA 76), Conn.	12.5
CIGNA Corp. (Active), Conn.	12.5
General American (SA 8), Mo.	12.4
Shawmut Bank, Mass.	12.4
Mutual of New York (Public)	12.4
State Street Bank, Mass.	12.4
Liberty Nat'l, Ky.	12.4
Wellington Trust (G/C), Mass.	12.4
Shearson Lehman G/C Index	**12.3**

10-year returns

	%
United of Denver	13.4
Beverly Bank, Ill.	13.3
Sovran Bank (Inst.), Va.	13.1
Centerre Trust, Mo.	12.6
Pacific Mutual, Calif.	12.5
American Security, D.C.	12.4
Seattle First Nat'l	12.4
Seafirst Bank, Wash.	12.4
Fidelity Bank, Pa.	12.3
Texas Commerce (Active)	12.3
First Kentucky Trust	12.1
Life of Virginia	12.0
Sanwa Bank (C), Calif.	11.9
First Interstate of California	11.9
Hibernia Nat'l, La.	11.7
Morgan Guaranty, N.Y.	11.7
First Interstate of Arizona	11.7
First Wisconsin Asset	11.7
First Jersey Nat'l, N.J.	11.6
Central Fidelity, Va.	11.6
Connecticut Nat'l Bank	11.6
Cullen Bank, Texas	11.5
Sovran Bank/Central South	11.5
Bank of New England, Mass.	11.5
Northern Trust (Inter.), Ill.	11.4
IAA Trust (B), Ill.	11.4
Boatmen's FNB Kansas City, Mo.	11.4
Bankers Trust (B), N.Y.	11.4
Mercantile Bank, Mo.	11.3
John Hancock, Mass.	11.3
Manufacturers Detroit	11.3
Bankers Trust (A), N.Y.	11.3
Second Nat'l Bank (Emp.), Ohio	11.3
Mid-State Bancorp, Pa.	11.3
Boatmen's Nat'l, Mo.	11.2
American Nat'l Bank, Tenn.	11.2
Ameritrust (Reserve), Ohio	11.2
Merchants Nat'l, Pa.	11.2
Colonial American Nat'l, Va.	11.2
First Bank Milwaukee	11.1
First Chicago	11.1
Trustcorp Bank, Ohio	11.1
First Wachovia, N.C.	11.0
Bessemer Trust, N.Y.	11.0
Society Nat'l, Ohio	11.0
First of Maryland	11.0
Jefferson Trust, Ill.	11.0
CIGNA Corp. (Active), Conn.	11.0
Key Trust, N.Y.	11.0
Indiana Nat'l Bank	11.0
Chancellor Capital, N.Y.	11.0
Shearson Lehman G/C Index	**10.7**

Top quartile commingled equity funds

3-month returns

	%
Gary Wheaton Bank (Hedged), Ill.	5.3
U.S. Nat'l of Galveston, Texas	5.2
Nat'l Bank of Commerce, Tenn.	4.5
Employers Life of Wausau (SA 1)	3.7
Nat'l Bank of Commerce, Neb.	3.7
Union Central, Ohio	3.6
Key Trust Co. of Alaska	3.6
Associated Manitowoc, Wis.	3.4
Merchants Nat'l (I), Ind.	3.4
United Carolina Bank, N.C.	3.4
Jefferson Trust (Growth), Ill.	3.3
American Security (High yield)	3.3
New York Life (SA 6)	3.2
Merchants Nat'l (2), Ind.	3.2
LaSalle Nat'l (Intrinsic), Ill.	3.2
Provident Mutual (SA 1), Pa.	3.1
Crown Life (U.S. grp.), Ontario	3.0
Home Life, N.Y.	2.9
Equitable Capital (1), N.Y.	2.9
Bank One, Indianapolis (G)	2.7
Citizens Com (Div. growth), Mich.	2.7
WestStar Bank, Okla.	2.7
MTrust, Texas	2.6
Associated Bank (Neenah), Wis.	2.6
Equitable Capital (4), N.Y.	2.6
Citytrust (E1), Conn.	2.5
First Jersey Nat'l, N.J.	2.5
Markston Invest. Mgmt., N.Y.	2.4
Mercantile Nat'l, Ind.	2.4
Indiana Nat'l Bank	2.4
Security Pacific, Calif.	2.4
Travelers (SA DR), Conn.	2.4
Summit Bank, Ind.	2.3
Stock Yards Bank (Trust), Ky.	2.3
SLH Trust (Contrarian 6), Del.	2.2
C&S Trust Florida	2.2
John Hancock (1K), Mass.	2.1
Midlantic Nat'l, N.J.	2.1
Second Nat'l, Ohio	2.1
NCNB Texas (Income)	2.1
Gary Wheaton Bank, Ill.	2.0
Great West Life (VAAA), Manitoba	2.0
First Chicago	1.9
Bank of California	1.9
Security Nat'l Bank (II), W. Va.	1.8
Confederation Life, Ontario	1.8
Sentry Equity (SA 9), Wis.	1.8
Bank of New York	1.7
Banc One Asset (Corp.), Ohio	1.7
Security Pacific (B), Calif.	1.7
Sanwa Bank (D), Calif.	1.7
Lincoln Nat'l Pens. (Select), Ind.	1.7
First Interstate Billings, Mont.	1.7
Associated Kellog, Wis.	1.6
Key Trust, N.Y.	1.6
Central Bank Monroe, La.	1.6
Firstier Bank	1.6
First Nat'l Mercantile (A), Mo.	1.6
Chicago Title & Trust	1.6
Stock Yards Bank, Ky.	1.6
MTrust (Growth), Texas	1.5
Unibanctrust, Ill.	1.5
Capital Trust (I), Ore.	1.5
Security Nat'l Bank, W. Va.	1.4
Prudential (PRIFORM low p/e)	1.4
Wilmington Trust (Value), Del.	1.4
Citizens Com. (Value), Mich.	1.4
Bank of Oklahoma, Tulsa	1.4
Harris Trust (Low p/e), Ill.	1.4
American Nat'l Chicago (Active)	1.3
Bishop Trust, Hawaii	1.3
Nat'l City Cleveland	1.3
First Trust Corp., Colo.	1.2
SLH Trust (Value 4), Del.	1.2
Bank of Delaware (VIP)	1.2
Dominion Trust (Corp.), Va.	1.2
Standard & Poor's	**0.3**

WISHFUL THINKING WON'T MEET THE MEDICAL DEMANDS OF TOMORROW'S RETIREES.

Health care costs continue to skyrocket. Employees are retiring earlier. Living longer. And the baby boom is getting gray.

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When you need us most, we're at our best.

THE HARTFORD
The Insurance People of ITT

Top equity funds by size

1-year returns

Over $100 million

	%
First Chicago, Ill.	16.5
Markston Invest. Mgmt.	0.6
Fidelity Mgmt. (Inc.), Mass.	1.1
First Jersey Nat'l, N.J.	3.4
U.S. Nat'l Oregon (Qualivest)	3.9
Massachusetts Mutual	6.3
Provident Capital, Pa.	6.4
Nat'l Bank of Detroit	7.0
Meridian Trust, Pa.	7.1
Mutual of New York (Income)	7.4

$50 million to $100 million

	%
Travelers (SA), Conn.	1.3
NCNB Texas (Divers.)	0.0
Sovran Bank (Inst.), Va.	0.5
Centerre Trust, Mo.	1.5
The Phoenix, Conn.	2.9
Sentry Equity (SA B), Wis.	4.3
Bank of California (Income)	6.1
Chicago Title & Trust	6.6
Chancellor (Stock-of), Mass.	7.1
American Security, D.C.	7.8

$10 million to $50 million

	%
U.S. Nat'l of Galveston, Texas	3.1
Nat'l Bank of Commerce, Tenn.	0.8
Jefferson Trust (Growth), Ill.	0.7
Crown Life (U.S. grp.), Ontario	0.3
First Fidelity (Disc.), N.J.	0.2
First of Maryland	0.5
Liberty Nat'l, Ky.	1.7
American Nat'l, Minn.	2.1
SLH Trust (Value 4), Del.	2.7
Central Bank Monroe, La.	2.8

Under $10 million

	%
PW Trust (Conserv.), N.J.	11.4
Gary Wheaton (Hedged), Ill.	4.0
Security Nat'l, W. Va.	1.2
State Bank (C), Ohio	1.1
American Security (H. yield)	2.0
First Interstate of Oregon	3.9
Bank One Indianapolis (C)	4.3
Security Nat'l (II), W. Va.	4.5
United Carolina, N.C.	5.0
Calcasieu Marine (E), La.	5.1

10-year returns

Over $100 million

	%
Sun Bank, Fla.	22.3
Manufacturers Life, Ontario	20.5
First Union Bank, N.C.	19.4
U.S. Nat'l Oregon (Qualivest)	18.9
Bessemer Trust, N.Y.	18.7
Union Labor Life (SA A), D.C.	18.6
Provident Capital, Pa.	18.0
MTrust (Growth), Texas	17.9
Equitable Capital (4), N.Y.	17.8
Manufacturers Detroit	17.2

$50 million to $100 million

	%
The New England (Sep. cap.)	18.2
NCNB Texas (Divers.)	17.6
Sentry Equity (SA B), Wis.	16.6
Sovran Bank, Va.	16.4
The Phoenix, Conn.	16.3
Continental Bancorp, Pa.	16.1
Texas Commerce (Divers.)	16.1
First Wisconsin Asset (A)	16.1
Mercantile Safe, Md.	15.9
Chase Manhattan (B), N.Y.	15.7

$10 million to $50 million

	%
First Fidelity (Disc.), N.J.	19.9
Guardian Ins. (VA 1), N.Y.	19.0
First Interstate of Oklahoma	18.9
United of Denver	18.8
U.S. Nat'l of Galveston, Texas	18.3
Confederation Life, Ontario	17.7
MTrust (Value), Texas	17.7
First Trust Corp., Colo.	17.5
Home Life, N.Y.	17.5
First of Omaha (D), Neb.	17.3

Under $10 million

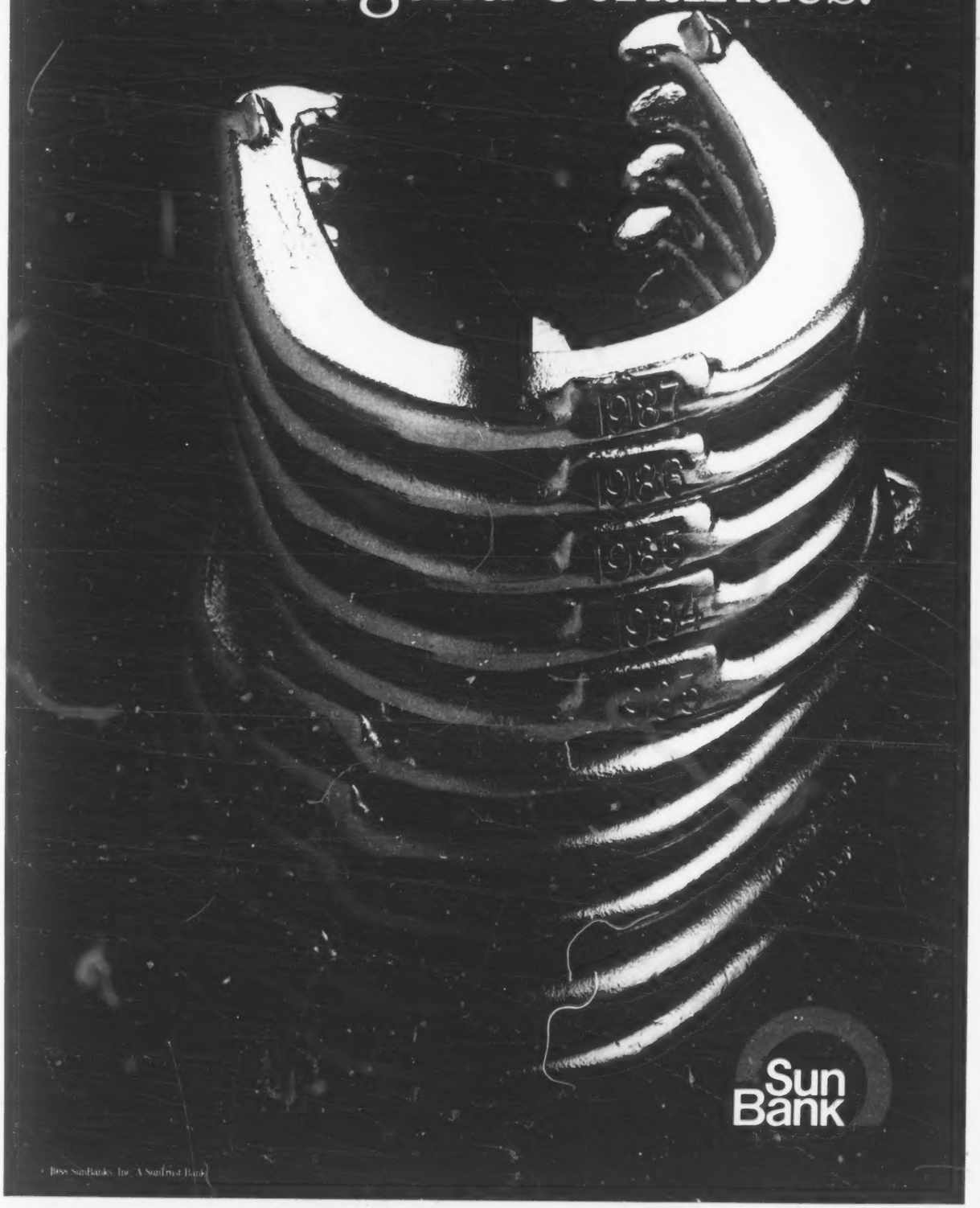
	%
First N.H. Investment (A)	18.2
First Interstate of Oregon	17.2
Wheeling Dollar Bank, W. Va.	17.1
Second Nat'l, Ohio	15.5
Unibanctrust, Ill.	15.4
First Nat'l of Commerce, La.	15.0
Merchants Nat'l (2), Ind.	14.9
Bank of California (Inc. growth)	14.4
Puget Sound Nat'l, Wash.	14.1
Associated Manitowoc, Wis.	14.0

We are SunBank. And our record of consistent brilliant performance is the name of the game:

According to PIPER, returns on our Corporate Equity Fund for five and ten years are higher than those equity fund returns of every other bank and insurance company in the nation.
(Pensions & Investment Age 8/22/88)

If you want results, call Victor Zollo, Jr., Senior Vice President of our Investment Management Group, at (407) 237-4532.

The Legend Continues.



Sun Bank

Bess SunBanks, Inc. A SunTrust Bank

PIPER

1-year returns

	%
First Chicago	16.5
PW Trust (Conserv.), N.J.	11.4
Gary Wheaton Bank (Hedged), Ill.	4.0
Union Central, Ohio	3.6
U.S. Nat'l of Galveston, Texas	3.1
Travelers (SA), Conn.	1.3
Security Nat'l Bank, W. Va.	1.2
Nat'l Bank of Commerce, Tenn.	0.8
Jefferson Trust (Growth), Ill.	0.7
Crown Life (U.S. grp.), Ontario	0.3
NCNB Texas (Diverse)	0.0
First Fidelity (Discr.), N.J.	0.2
Sovran Bank (Inst.), Va.	0.5
First of Maryland	0.5
Markston Invest. Mgmt., N.Y.	0.6
Fidelity Mgmt. (Income), Mass.	1.1
State Bank (C), Ohio	1.1
Centerre Trust, Mo.	1.5
Liberty Nat'l, Ky.	1.7
American Security (High yield)	2.0
American Nat'l, Minn.	2.1
SLH Trust (Value 4), Del.	2.7
Central Bank Monroe, La.	2.8
The Phoenix, Conn.	2.9
Beverly Bank, Ill.	3.2
First Jersey Nat'l, N.J.	3.4
Shawmut Bank, Mass.	3.5
First Interstate of Oregon	3.9
U.S. Nat'l of Oregon (Qualivest)	3.9
First American of Georgia	4.1
Sentry Equity (SA B), Wis.	4.3
United of Denver	4.3
Bank One, Indianapolis (C)	4.3
Home Life, N.Y.	4.3
State Street (Matrix syn.), Mass.	4.5
Security Nat'l (III), W. Va.	4.5
Chancellor (Stockshift 200), N.Y.	4.6
NCNB Texas (Income)	4.6
Colorado Nat'l Bank	4.6
Key Trust, N.Y.	4.7
MTrust (Value), Texas	4.7
Stock Yards Bank (Trust), Ky.	4.9
Dominion Trust (Corp.), Va.	5.0
Bank One Indianapolis (G)	5.0
C&S Trust Florida	5.0
United Carolina Bank, N.C.	5.0
First of Omaha (D), Neb.	5.1
Guardian Ins. (VA 1), N.Y.	5.1
Calcasieu Marine Nat'l (E), La.	5.1
Harris Trust (Low p.e.), Ill.	5.1
Mercantile Nat'l, Ind.	5.2
First N.H. Investment (A)	5.2
Cullen Bank, Texas	5.3
WestStar Bank, Okla.	5.5
Wilmington Trust (Growth), Del.	5.6
Confederation Life, Ontario	5.7
Southeast Bank, Fla.	5.7
Citizens Com. (Value), Mich.	5.8
LaSalle Nat'l (Instrinsic), Ill.	5.9
South Carolina Nat'l	6.0
Bank of California (Income)	6.1
Bank of Oklahoma, Tulsa	6.2
Pioneer Bank, Ill.	6.3
First Alabama Bank (I)	6.3
Massachusetts Mutual	6.3
Provident Capital, Pa.	6.4
Mid-State Bancorp, Pa.	6.5
Nat'l Bank of Commerce, Neb.	6.6
Chicago Title & Trust	6.6
First Variable Life, Ark.	6.6
First Interstate of Oklahoma	6.7
Indiana Nat'l Bank	6.8
Citizens Fidelity (E), Ky.	6.8
First Illinois (Personal)	6.9
Stock Yards Bank	7.0
State Street Bank (I), Mass.	7.0
Maryland Nat'l	7.0
Nat'l Bank of Detroit	7.0
Standard & Poor's	12.4

3-year returns

	%
Bank One, Indianapolis (C)	28.8
State Bank (C), Ohio	26.8
Sun Bank, Fla.	26.4
South Carolina Nat'l	23.7
California First Bank	23.2
SLH Trust (Value 4), Del.	23.2
NCNB Texas (Diverse)	23.1
State Street (Matrix syn.), Mass.	22.5
Capital Trust (I), Ore.	22.2
First Chicago	22.1
First Fidelity (Disc.), N.J.	21.6
Harris Trust (Low p.e.), Ill.	21.1
Guardian Ins. (VA 1), N.Y.	21.1
First Illinois (Corp.)	20.9
Cullen Bank, Texas	20.9
Chancellor (Multifact), N.Y.	20.8
SLH Trust (Flex 7), Del.	20.8
Crown Life (U.S. grp.), Ontario	20.8
United of Denver	20.8
First Illinois (Personal)	20.5
NCNB Texas (Income)	20.3
Sovran Bank, Va.	20.1
Citizens Fidelity (E), Ky.	19.9
Firstier Bank	19.9
First of Maryland	19.9
Harris Trust, Ill.	19.8
Southtrust Bank, Ala.	19.8
First Security Nat'l (D), Ky.	19.8
State Street Bank, Mass.	19.7
U.S. Nat'l of Oregon (Qualivest)	19.6
Bank of New York	19.6
Associated Bank (Neenah), Wis.	19.6
First Fidelity Bank, N.J.	19.6
College Ret. Equities Fund	19.5
Nat'l Bank of Commerce, Tenn.	19.5
IDS Trust (A), Minn.	19.5
Puget Sound Nat'l, Wash.	19.4
Associated Manitowoc, Wis.	19.4
First Interstate of Oklahoma	19.4
Dominion Trust (Corp.), Va.	19.2
American Nat'l, Minn.	19.2
Chase Investors (Index), N.Y.	19.2
U.S. Nat'l of Galveston, Texas	19.1
John Hancock (1K), Mass.	19.1
Mutual of New York (Income)	19.1
Markston Investment Mgmt., N.Y.	19.0
State Street (Value I), Mass.	19.0
Employers Life of Wausau (SA 1)	19.0
The Phoenix, Conn.	18.9
First Interstate California (Index)	18.9
Maryland Nat'l	18.9
Wellington Trust (Div. growth)	18.9
Confederation Life, Ontario	18.7
Meridian Trust, Pa.	18.7
Travelers (SA), Conn.	18.6
Chancellor (Indexplus), N.Y.	18.6
Pioneer Bank, Ill.	18.5
First American of Georgia	18.5
Nat'l City Cleveland	18.5
Bankers Trust (Index), N.Y.	18.5
Morgan Guaranty (Large co.)	18.4
The Principal, Iowa	18.4
Security Pacific (E), Calif.	18.4
Home Life, N.Y.	18.4
Valley Nat'l (I), Ariz.	18.4
First N.H. Investment (A)	18.4
Standard & Poor's	18.3
Beverly Bank, Ill.	18.3
State Street Bank (S&P)	18.3
Barnett Banks, Fla.	18.3

5-year returns

	%
Sun Bank, Fla.	24.0
State Bank (C), Ohio	19.1
NCNB Texas (Divers.)	18.5
First Fidelity (Disc.), N.J.	18.1
Cullen Bank, Texas	17.7
MTrust (Value), Texas	17.5
Guardian Ins. (VA 1)	17.4
First Interstate of Oregon	17.1
Nat'l Bank of Commerce, Tenn.	17.1
First of America, Mich.	16.9
U.S. Nat'l of Galveston, Texas	16.9
Mellon Equity Associates	16.5
Union Labor Life (SA A), D.C.	16.5
First N.H. Investment (A)	16.4
First Chicago	16.3
First of Omaha (D), Neb.	16.2
Nationwide Life, Ohio	16.1
Manufacturers Detroit	16.1
Bank of New England (Valuepath)	16.1
Mutual of New York (Income)	16.0
Meridian Trust, Pa.	15.9
The Phoenix, Conn.	15.9
Barnett Banks, Fla.	15.9
Associated Bank (Neenah), Wis.	15.9
Sovran Bank, Va.	15.8
Colorado Nat'l Bank	15.8
First American of Georgia	15.7
Citizens Fidelity (E), Ky.	15.7
Citytrust (E1), Conn.	15.7
SLH Trust (Directions 1), Del.	15.7
John Hancock (1K), Mass.	15.6
Dominion Trust (Corp.), Va.	15.6
First Alabama (I)	15.6
C&S Trust Florida	15.5
Confederation Life, Ontario	15.5
NBD Trust, Ill.	15.5
College Ret. Equities Fund	15.3
Frost Nat'l (A), Texas	15.3
Morgan Guaranty (Large co.)	15.3
Pioneer Bank, Ill.	15.3
Sentry Equity (SA B), Wis.	15.1
First Security Nat'l (D), Ky.	15.0
First Union Bank, N.C.	15.0
Northern States Trust, Ill.	14.9
First of Maryland	14.9
First Trust Corp., Colo.	14.9
LaSalle Nat'l (Instrinsic), Ill.	14.9
Associated Manitowoc, Wis.	14.9
Lake Shore Nat'l, Ill.	14.9
First Fidelity, N.J.	14.9
Bankers Trust (Index), N.Y.	14.9
Provident Capital, Pa.	14.9
Signet Trust, Va.	14.8
New Jersey Nat'l	14.8
Ameritrust (Divers.), Ohio	14.8
Fidelity Mgmt. (Income), Mass.	14.8
Wells Fargo (Index), Calif.	14.8
Chancellor Capital (Indexplus)	14.7
Standard & Poor's	14.7

THE STRONG. THE BRILLIANT.

Risky technique

Continued from page 17

doesn't characterize the portfolio managers as traders most of the time.

"We're always looking for new ideas," he said. "President Reagan has come up with new agency paper that's very attractive and has made money with extra yield.

"In sector analysis, we're careful about event risk. Right now, we're almost completely out of corporates."

The portfolio consists of 50% long Treasuries, 30% mortgages and 20% agencies, Mr. Franklin said.

A fund run by Beverly Trust Co., Chicago, ranked second for the year with 18.6%, and Separate Account 9 of the General American Life Insurance Co., St. Louis, was third with with 17.5%.

Beverly concentrates its holdings on high-coupon corporate bonds with short calls, according to President Ron Stajkowski. He said the fund has done very little trading in the past year, but if interest rates have peaked, as he believes, he will sell and extend from his current holdings. Holdings include **Santa Fe Southern Pacific Corp.** and **Litton Industries Inc.**

A perennial PIPER winner, the $40 million Collective Employee Benefit Fund run by United Capital Management of Denver for United Bank of Denver, placed first for the three-, five- and 10-year periods ended Sept. 30, with compound annualized returns of 15.2%, 16.1% and 13.4% respectively.

The fund anticipates major changes in interest rates, according to W. Lon Schreur, president of United Capital Management. It is invested 50% in U.S. government bonds and 50% in A-rated, short-term corporates.

Bonds were kept "at a 22-year average life from 1981 to 1986, because we thought the value of the dollar was going down and the industry sector was strengthening," Mr. Schreur said.

The average life then went to six years and has decreased steadily since 1986 to about three years, Mr. Schreur said.

Although he doesn't see a recession now, he believes it's coming early next year, and he expects the average life of the bonds in the fund will be extended again.

Ranking second for the three-year period was the Delaware Trust fund, with a compound annualized 15.2%. Equitable Capital Management Corp., New York, was third, with an annualized 14.6%. ■

Value in equities

Continued from page 17

Communications Corp. and **Deere & Co.**

The fund tends to be overweighted in financial stocks, he said, and has no exposure to small technology stocks.

In second for the year was the conservative equity fund of PW Trust Co., Secaucus, N.J.

This fund returned 11.37% for 12 months, its first full year of operation. The $2 million fund is managed by McBryan, Malone & Russell of Reading, Pa. In the quarter, it returned 1.02%.

"The fund generally has to be fully invested," said Bill Russell, partner in McBryan, Malone & Russell.

He said the fund's strong performance is due in part to its writing covered call options against the stocks held.

Dave Kinard, president of PW Trust, said the fund will buy stocks that are "the least likely to go down," and it will hold the stocks until someone exercises the options and buys the stock.

The top performer for the three-year period was the Retirement Fund C fund managed by Bank One of Indianapolis, with a 28.85%. For the same period, the S&P 500 returned 18.3%, while the PIPER median returned 16.6%.

All PIPER returns for periods of more than one year are compound annualized.

The corporate equity fund of Sun Banks, Orlando, Fla., returned 26.42% for the three-year period, finishing third. The $380 million fund is actively managed and has a historic turnover of 200%, according to Tony Gray, president of Sun Bank Investment Management Group.

The Sun Banks fund was the top performer for the five- and 10-year periods as well, although it has fallen to the seventh and sixth deciles for the quarter and year, respectively.

For the five-year period, it returned a compound-annualized 23.97%, compared with a 14.72% return for the S&P 500 and a PIPER median return of 12.95%.

For the 10 years, the fund topped the PIPER performers, with a 22.3% return, compared to an S&P 500 return of 15.42% and a PIPER median return of 14.75%. ■

Massachusetts Mutual	14.7
State Street Bank (S&P)	14.7
Irving Trust, N.Y.	14.7
Chase Investors (CMB index)	14.7

10-year returns

	%
Sun Bank, Fla.	22.3
Manufacturers Life, Ontario	20.5
First Fidelity (Disc.), N.J.	19.9
First Union Bank, N.C.	19.4
Guardian Ins. (VA 1), N.Y.	19.0
U.S. Nat'l of Oregon (Qualivest)	18.9
First Interstate of Oklahoma	18.9
United of Denver	18.8
Bessemer Trust, N.Y.	18.7
Union Labor Life (SA A), D.C.	18.6
U.S. Nat'l of Galveston, Texas	18.3
The New England (Sep. cap.)	18.2
First N.H. Investment (A)	18.2
Provident Capital, Pa.	18.0
MTrust (Growth), Texas	17.9
Equitable Capital (4), N.Y.	17.8
Confederation Life, Ontario	17.7
MTrust (Value), Texas	17.7
NCNB Texas (Diverse)	17.6
First Trust, Colo.	17.5
Home Life, N.Y.	17.5
First of Omaha (D), Neb.	17.3
First Interstate of Oregon	17.2
Manufacturers Detroit	17.2
Wheeling Dollar Bank, W. Va.	17.1
Nationwide Life, Ohio	16.9
Massachusetts Mutual	16.9
Employers Life of Wausau (SA 1)	16.8
C&S Trust Florida	16.7
Nat'l Bank of Commerce, Neb.	16.7
First Fidelity, N.J.	16.7
Sentry Equity (SA B), Wis.	16.6
Lake Shore Nat'l, Ill.	16.6
Markston Invest. Mgmt., N.Y.	16.5
Citytrust (E1), Conn.	16.5
State Street Bank, Mass.	16.5
Colorado Nat'l Bank	16.5
American Nat'l Chicago (Active)	16.5
Signet Trust, Va.	16.4
Core States Invest., Pa.	16.4
Sovran Bank (Inst.), Va.	16.4
The Principal, Iowa	16.3
The Phoenix, Conn.	16.3
Nat'l City Cleveland, Ohio	16.2
Continental Bancorp, Pa.	16.1
Texas Commerce (Divers.)	16.1
First Wis. Asset (Growth A)	16.1
Dominion Trust (Corp), Va.	16.1
Connecticut Mutual	16.0
Mercantile Safe, Md.	15.9
Mutual of New York (Income)	15.9
Firstier Bank	15.9
Citizens Fidelity (E), Ky.	15.9
Aetna Life, Conn.	15.9
Standard & Poor's	**15.4**

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* Pacific Mutual Managed Bond Fund III total annualized rate of return as published by SEI Corp. for periods ending December 31, 1987

WINTER 1988

PROPERTY

A Pensions & Investment Age Supplement on Real Estate

Photo by Doug Kilmer

Urban developer looking for profits down on the farm

Jack Straton oversees Crow Farms, the latest real estate investment strategy of Trammell Crow. Mr. Crow, best known as the world's largest urban developer, has farm holdings totaling 53,000 acres on six southern plantations — Page P7.

Las Colinas sale imminent

By Andrew Reinbach

Teachers Insurance and Annuity Association and JMB Realty Corp. expect to acquire a large joint interest in Las Colinas, the 12,000-acre planned community outside Dallas, in a complex transaction that will take Southland Financial Corp. private and leave the family that created Las Colinas with a majority of its equity, but virtually no control.

Although negotiations with creditors are incomplete, a picture of the structure of the deal emerges from documents filed with the Securities and Exchange Commission and from interviews with the parties involved.

● The Carpenter family of Dallas (headed by Ben H. Carpenter, the developer of Las Colinas and head of Southland Financial, Las Colinas' parent company) would get general partnership interests in 60% of 2,300 acres of undeveloped land in Las Colinas, and 49.9% of the remainder of Southland once Las Colinas and Southland are spun off into separate entities.

● JMB, Chicago, would get general partnership interests in 20% of the land entity and 25% of the Southland entity.

● TIAA, New York, would be a limited partner in 20% of the land and 25.1% of Southland.

But the Carpenters would have no say over the management of the citylike development they created, although two family members would be on the five-person executive committee. Two committee members would come from JMB, and one from TIAA.

The Carpenters' only active role would be as property managers, under a contract that, after two years, becomes an annual contract that could be canceled with 30 days' notice. The Carpenters also would pay all the expenses of the management company, and transaction costs of up to $2 million for TIAA and JMB.

If the deal is complete, TIAA will pay $2 per share, or more than $33.5 million, to acquire Southland's outstanding shares. The $11.8 million the Carpenters will get as owners of 35.2% of Southland would be contributed to the new partnership.

Strategic planning and control of both entities would pass to JMB, which gets a $12.5 million transaction fee if the deal closes. JMB also would be paid $1 million per year and 3.1% of the gross operating income, and would get at least 50% in the equity of any future development.

TIAA gets a $250 million participating mortgage with a base rate of 11.6%, of which 7% accrues to a periodically paid-down account designed to keep the loan-to-value ratio at 75%. If the Carpenters get a better offer within 18 months of closing, TIAA gets a $2.5 million fee. TIAA and JMB also have certain limited partnership options on the nine non-land assets, which will be retained and actively managed.

The parties have been negotiating since January; John Somers, TIAA's senior vice president for real estate, said he hopes to have a signed deal by year end.

Continued on page P10

China emerges

6 U.S. projects under way

By Andrew Reinbach

NEW YORK — The People's Republic of China has entered the U.S. real estate market, choosing to develop, rather than buy, properties.

The China State Construction Engineering Corp. — U.S. Inc. mainly is developing residential properties, but representatives say they can finance any project that pays, and are looking at developing commercial property as well.

"We are not interested in buying and selling like the Japanese," said Cao Wanhua, executive vice president in charge of the U.S. venture. "And since we are not familiar with the market, it is hard to say what the target of the portfolio is. We are starting our market study, and at this time it is difficult for me to say how much money we would invest."

China State has been in a Manhattan suite since January. The firm is building six projects nationwide, including an 85-acre marina and housing development for which land negotiations are under way in Waikiki Beach, Hawaii; 224 condominiums in Middletown, N.Y.; the 500-unit Lanterna Park housing development in Jacksonville, Fla.; 418 retirement apartments in Atlanta; and a single-family residential development in Somers, N.Y., intended to capitalize on a large facility being built there by International Business Machines Corp.

Although most of the projects are joint ventures with local developers, China State is sole developer in Jacksonville.

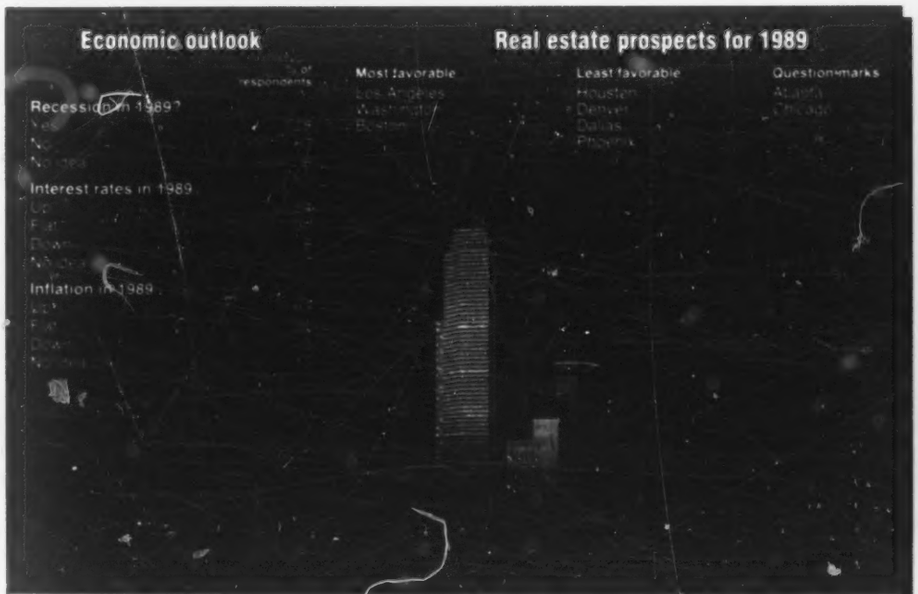
China State is not a government entity. "We are a state enterprise and not (acting) on behalf of the government," Mr. Cao said. "I am a businessman. We borrow money, and pay the money back with interest. We are totally responsible for repayment of the loans, and must repay them from the income of the projects."

Mr. Cao said his firm has lines of credit with the Hong Kong Shanghai Bank, the Bank of China and the Kawah Bank, Hong Kong. He also is working with Paul Theil, a senior associate at Morgan Stanley & Co., New York, and Steven Orlins, a Hong Kong-based managing director of Shearson Lehman Hutton Inc.

The amount of money available "depends on the project itself, and on the income produced by the project. If the project itself looks good, we can get the financing," he said.

"They're going to function as effectively as the Japanese, and become very skilled in acquiring expertise, and very efficient at using the expertise of their local partners," said Stan Ross, a managing partner at Kenneth Leventhal & Co., Los Angeles. Leventhal has produced several feasibility studies for China State. "But they won't become major

Continued on page P11



Next year's strategies are this year's trends

By Chuck Paustian

Real estate professionals might want to look back to better understand where they are going.

Indeed, the economic, financing and investing outlooks for 1989 appear to be a repeat of 1988, with a resurgence of some strategies and an expansion of others begun in 1988.

Interviews by PROPERTY and those from the report, "Emerging Trends in Real Estate: 1989" (prepared by Real Estate Research Corp., Chicago, and underwritten by Equitable Real Estate Investment Management Inc., New York) show:

● An abundance of real estate equity capital will be available — leading investment firms have about $10.4 billion in equity capital to invest for their pension fund clients alone — but the limited supply of top-quality properties will hamper the investment process.

● Traditional realty lenders will remain cautious in their financing activities next year, especially in the office sector, where overbuilding continues to be a major concern.

● Increased competition among both foreign and domestic institutional investors and the limited supply of quality properties

Continued on page P13

Next strategies

Continued from P1

will force investors to broaden their horizons and consider such financing vehicles as participating mortgages and such investment opportunities as raw land.

- Some of the more intriguing deals of 1988 — corporate real estate transactions and contrarian, opportunistic approaches to depressed markets, such as the Oil Patch — should remain attractive sources of deals next year.
- Most financiers and investors are not expecting a recession in 1989 and think interest rates and inflation will increase, but by no more than 100 basis points.

Private capital sources, including banks, insurance companies and pension funds, will continue to dominate real estate financing activity.

Salomon Brothers data show an estimated $140 billion in commercial, long-term mortgages will be originated in 1988, down from $170 billion in 1987. Commercial mortgage securities issues through the end of September totaled about $5 billion, compared with $8.75 billion in 1987.

Data from Alex. Brown & Sons Inc., Baltimore, show a similar drop in public equity financings. As of Oct. 31, there were 14 offerings totaling about $900 million, compared with 22 real estate equity offerings totaling $1.2 billion in 1987.

Private sources of equity financing are expected to remain plentiful, as domestic pension funds and foreign investors continue to expand their real estate portfolios. The leading real estate investment managers of pension fund assets, for example, had a total of about $94.6 billion under management as of June 30, of which $72.5 billion was earmarked for equity investments.

Real estate equity investors, however, will find it difficult to put their money to work. Of the $72.5 billion already placed with real estate advisers, about $10.4 billion had yet to be invested.

According to the RERC report and other executives, the dearth of quality opportunities is the result of several factors: a slowdown in construction activity as a result of overbuilding in many markets; low turnover of existing properties; and the difficulty in keeping a property in the top echelon of the market.

"There's a lot more money available to invest than there is good real estate product to either finance or buy," said Philip J. Ward, senior vice president at CIGNA Investments Inc., Hartford, Conn.

"We bought a shopping center a couple months back. There were seven bidders on that property," noted Robert H. Gidel, managing director of Alex. Brown Realty Advisors Inc., Baltimore. "With seven bidders, you kind of wonder what you've won."

Real estate equity investors, however, may be able to take advantage of a slowdown in lending activity by commercial banks, savings and loan associations and insurance companies.

"I would label it continued cautiousness," said Raymond Smith, senior vice president-commercial real estate finance at Aetna Realty Investors Inc., Hartford, Conn. "We stopped doing to-be-built speculative office buildings about three to four years ago. For us to do any office buildings, they would have to be substantially leased and generate an income stream that comfortably covered debt service."

While debt financing for office buildings will be the most severely strained, lenders also will pull back on strip shopping centers; they are expected to remain remain aggressive on major malls.

James A. Hively, director-finance in the real estate department at Salomon Brothers Inc., New York, said any decline in fixed-rate debt financing could hurt developers that have been carrying projects with low, floating-rate debt.

"I think you're going to see people going to interest rate protection vehicles," said Mr. Hively, adding developers might use interest rate caps or refinance floating-rate debt at a fixed rate.

Several observers predicted an increase in participating mortgage activity as institutional investors, looking to invest their money, agree to provide fixed-rate debt financing in exchange for an equity position.

Real estate observers expect yields, which were between 11% and 12% in June, to continue their downward trend next year.

"Is it going to be business as usual? No," said Richard Collier, senior managing director at Bear Stearns & Co. Inc., New York.

"I think the new money is going to go increasingly toward a higher-performance asset."

Non-traditional investment areas mentioned by real estate professionals include timberland, land development, apartments and development deals. Others suggested a more contrarian approach to investing.

"It's a very good time to buy quality real estate, and I'd underline quality, in economically depressed areas such as the Southwest," noted B. Thomas Willison, vice president in the asset management and pension services department at The Travelers Corp., Hartford, Conn.

The executives said corporate real estate deals were the most significant transactions of 1988, more for the amount of activity this area is expected to generate in 1989 than for the financial structure of the deals.

Among the big corporate property deals so far this year are the $400 million sale to Prudential Mortgage Capital Co., Newark, N.J., of Chicago-based Santa Fe Southern Pacific Corp.'s income-producing properties and the $550 million acquisition of McCormick Properties Inc., a subsidiary of Baltimore-based McCormick & Co. Inc., by a joint venture between the Teacher's Insurance and Annuity Association — College Retirement Equities Fund, New York, and The Rouse Co., Columbia, Md.

About two-thirds of the executives interviewed for the RERC report and all of those contacted by PROPERTY said they did not expect a recession in 1989.

Regarding interest rates and inflation, most professionals anticipate only slight increases. Of those interviewed for the RERC report, 54% expect interest rates to climb, while 63% said the inflation rate will increase.

Executives contacted by PROPERTY generally agreed with the report. Bear Stearns' Mr. Collier, however, held a dissenting opinion on interest rates.

"I sense that interest rates will soften through mid-year," he said, adding interest rates could fall by 50 to 100 basis points.

There was more agreement among the executives about the inflation rate. "You have a fairly tight employment situation, but overall, wage pressure and other pressures are not dramatic," said Mr. Collier. ■

Foreigners

Continued from page P12

products, including its Courtyard hotels, which compete against Holiday Inns, he noted.

Marriott also is expanding its Fairfield Inns, an economy-class chain. This type of expansion into particular niches is called segmenting. In most cases, said Mr. Wheeler, the financing for segmenting is being done in-house.

Savings and loan associations, significant lenders to the hotel industry in the past, have reduced their hotel lending because of overall problem loans.

Financing from syndicators also has dropped off because tax law changes encourage them to lend only on economically viable hotels.

Pension funds, meanwhile, are increasing their lending on hotels, but are still considered a small player.

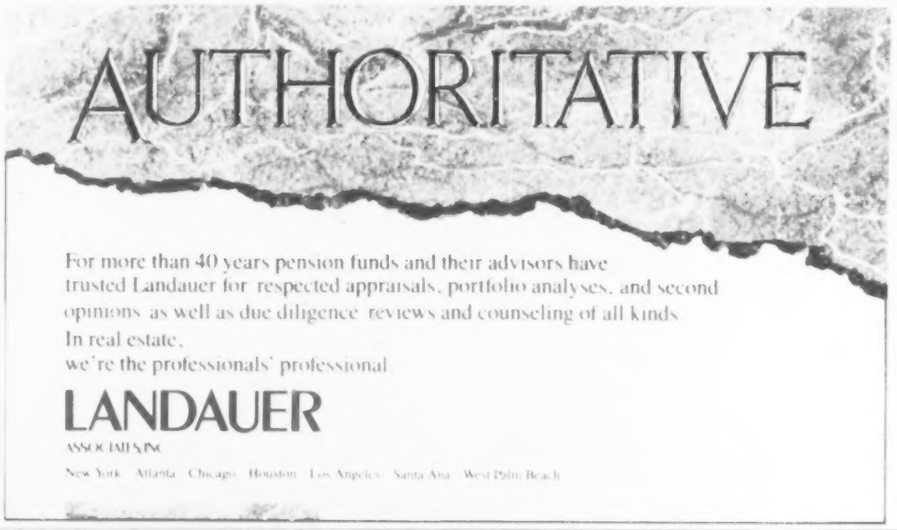
Hotel construction down

With less money for financing of hotels, and with foreigners primarily investing in existing hotels, hotel construction is down.

A Salomon Brothers report said new construction contract awards for hotels dropped 39% during the first half of 1988 from its midyear 1986 peak. This downtrend is expected to continue through 1989.

But demand for hotel rooms has been rising. In 1986, total hotel room demand increased 4.6% vs. a 4.1% increase in supply. In 1987, demand increased 5.3% and supply, 3.9%.

With rising demand and slower construction of hotel rooms, the years 1990 to 1995 could be good ones for the hotel industry. ■



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PUBLIC FUNDS

Texas voters approved an amendment to the state constitution creating the Texas Growth Fund for investment in venture capital enterprises and small businesses within the Lone Star State.

Texas fund execs wary of new plan

By Fred Williams

AUSTIN, Texas — A provision to establish a state investment fund to help stimulate the Texas economy has encountered resistance from the state's major public retirement systems only days following its approval by voters Nov. 8.

The amendment to the state constitution creating the Texas Growth Fund will allow venture capital and direct investments in new and growing Texas businesses. The amendment specifically cited the Employees Retirement System of Texas, the Teacher Retirement System of Texas, the Texas Permanent School Fund and the Texas Permanent University Fund as major contributors.

Michael Patrick, the University of Texas system vice chancellor for asset management who helped draft the ballot provision, said, however, other municipal pension funds also may contribute to the Texas Growth Fund.

"I understand any public plan created by the Texas Constitution, including some city, fire and police funds, may participate."

Supporters claim the fund — which could grow to more than $300 million if the four major plans contributed the maximum allowed — would help stimulate economic development in Texas by providing seed money and investment capital for businesses in the state.

Mr. Patrick said the purpose of the fund is to establish a viable investment alternative for the funds as well as to help stimulate the state economy.

He said up to 10% of the Texas Growth Fund may be invested in venture capital deals. Of that portion, 75% would have to be invested through professional third-party venture capital asset managers. Up to 50% of the fund may be invested in debt or equity holdings for plant facility modernization, expansion or relocations. The remaining 40% could be invested in various ways including stocks, bonds, leveraged buy-outs or recapitalizations of Texas businesses.

"The investment standard for the fund is the prudent man standard. In my mind, that means that the fund must be invested professionally and in a serious attempt to make money for the fund and investors," Mr. Patrick said in response to critics who view the fund as a possible political tool of the Legislature and those who believe the fund will become a lender of last resort for businesses.

But the fund apparently does not have full support. Officials at the teachers, public employees and school systems are less than enthusiastic about the program.

"I don't see any particular benefit from it" to the teachers fund, said Joe Perrone, chief investment officer at the $17.5 billion teachers system. "I cannot see where this fund would gain anything by turning $100 million over to another body to invest in something we don't know much about.

Continued on page 36

State systems pump $2.2 billion toward LBO treasure chest

By Curtis Vosti

Nine of the 12 state pension funds known to be involved in leveraged buy-out funds have committed more than $2.2 billion, and although a critical eye is cast toward those investments these days, the market is still active.

Of the three funds that confirmed their participation but could not or would not provide commitment figures, one — the Washington State Investment Board — did note $500 million of its total commitment has not yet been drawn.

A year ago, the Washington fund valued its leveraged buy-out investments at $990 million, according to *Pensions & Investment Age*'s profiles of the nation's 200 largest pension funds (*P&I Age*, Jan. 25). The remaining two, the Michigan State Employees' Retirement Systems and the New York State & Local Retirement Systems, listed their investments at $110 million and $218 million, respectively, last year.

Public pension fund investment in leveraged buy-outs could jump another billion or more next year, as the $46 billion California Public Employees' Retirement System considers its initial foray into the field.

Even public pension systems whose executives have considered — and rejected — investments in leveraged buy-outs are being besieged by hungry buy-out firms seeking additional assets.

Joe Perrone, chief investment officer of the $17.5 billion Teacher Retirement System of

Continued on page 35

State pension fund commitments to leveraged buy-out funds

	$ millions
Wisconsin Investment Board	700
Oregon Public Employes	600
Iowa Public Employees	375
Minnesota State Board	190
Massachusetts PRIM	150
Illinois State Board	100
Utah State Retirement	100
Pennsylvania State Employes	33
Montana Board of Investments	25
New York State & Local	NA
Michigan State Employees	NA
Washington State Investment	NA

In-state programs

CDs used to assist small businesses

By Trudy Ring

The Colorado Fire and Police Pension Association, Englewood, has committed $10 million to a program to help small businesses in its state, while on a larger scale, four other public funds are looking into a similar, but federally sponsored, program.

Under both programs, assets are invested in certificates of deposit from local banks, which then use the money to make loans to small businesses.

The $560 million Colorado fire and police fund assets will be invested in certificates that provide a return about 30 basis points above that of 10-year Treasuries, said Johnnie Rogers, executive director. To date, the fund has bought one 10-year certificate and one seven-year one, but both have a return pegged to the 10-year Treasury, he said.

United Bank of Skyline, Denver, is the main lender in the program and made its first loan in September, he said. The certificates are guaranteed by the Federal Deposit Insurance Corp.

"It's a good deal for the bank, it's a good deal for the small businesses and it's a good deal for the pension fund," Mr. Rogers said.

The targeted funds for the federal program are the $8.8 billion Oregon Public Employes Retirement System, Salem, the $6.4 billion Arizona State Retirement System, Phoenix; the $2.7 billion Illinois State Board of Investment, Chicago, and the $800 million Cincinnati Retirement System.

None of the funds has yet decided to invest assets.

The National Development Council, New York, is coordinating the program, under the sponsorship of the Department of Housing and Urban Development. The council is a non-profit organization that assists cities and states with economic development.

The impetus for the program came from HUD, said Dorothy Harper, a director of the National Development Council. Finding funds for economic develop-

Continued on page 37

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Control

Continued from page 34

unable to do so in order to protect a corporate confidence — must abstain from trading in or recommending the securities concerned while the information remains undisclosed.

To keep the representative director from even inadvertently passing on to the institutional investor/fiduciary such inside information about the corporation, the investor would have to establish effective internal procedures and safeguards. Without these safeguards, the investor could be subject to lawsuit as the receiver of inside information.

Even more troubling is the possible treatment of the investor as a constructive director of the corporation under the deputization doctrine. The doctrine, as applied in Feder vs. Martin Marietta Corp., holds that when a director acts as another corporation's deputy, that corporation constructively becomes the director.

In Feder, Sperry Rand stock was being bought and sold by Martin Marietta while Martin Marietta's chief executive officer was serving on Sperry's board. The court held Martin Marietta constructively was a director of Sperry Rand because it had "deputized" its chief executive to act on its behalf. Martin Marietta had to disgorge its profits (as required by the 1934 Securities and Exchange Act) from purchases and sales of Sperry Rand stock.

If the deputization doctrine is applied here, the investor would be treated as possessing all the representative director's knowledge about the corporation. Certainly, if the director is on the corporation's board to speak for the institutional investor and its beneficiaries, that lends support to deputy status.

Any program of selling or buying by the investor while the representative director sits on the corporation's board would be touchy. The investor would have to time its sales carefully to make sure no material inside information was available to the corporation board but not to the public at the time of sale.

It is not certain such a policy would be workable, much less give the institutional investor the best timing to maximize gain from sales.

Moreover, the representative director may naturally — even unconsciously — use non-public information in his or her role as a member of the investor/fiduciary. Otherwise innocent transactions will take on an appearance of impropriety. Any purchase or sale of stock by the investor that coincides with the director's receipt of material, non-public information will create inevitable suspicion that the director disclosed that information to the investor/fiduciary.

Conclusion

The disadvantages to the investor of having a representative on the corporation's board of directors outweigh the advantages. The exposures to lawsuits are many and untested.

In a litigious society, the acceptance of a directorship by the investor's representative — given his or her fiduciary duties to the investor and potential characterization as a "deputy" of the investor — would only present an attractive "deep-pocket" target to derivative plaintiffs and their counsel for every real or imagined harm involving the corporation.

Instead, the institutional investor should consider being involved in director selection in ways that do not involve high exposure to lawsuit.

For example, with similarly situated institutional investors, the investor might designate a large number of independent qualified director candidates. From the number of candidates, management must select an agreed smaller number as part of its director slate. ■

LBOs

Continued from page 31

Texas, said he has received many such calls in the past year. The calls have been so numerous, he said, he can't even recall the name of the most recent caller seeking a commitment to a "megafund" of public investors.

Mr. Perrone said he declined the offer because the Texas teachers' board had determined the glory days of leveraged buy-out investments have passed, and the fund would not begin investing now.

"Maybe its something we should have gotten into earlier," he said. "There seems to be a whole lot more money (committed) than there are good deals."

The skyrocketing prices had been a reason the State of Wisconsin Investment Board decided in late 1987 to stopped additional funding of leveraged buy-out funds. Since 1984, the board had committed $700 million to various funds, but Marshall Burkes, executive director, said the "out of control" pricing and leveraged buy-out mania was disturbing.

"Something has to be out of line," he said. He applauded the decision Nov. 16 of Forstmann Little & Co., in whose leveraged buy-out fund Wisconsin is invested, to withdraw from the frenzied bidding for RJR Nabisco Inc.

The decision by the California employees' system to study leveraged buy-out investments is a cautious, although long-awaited one, said Basil Schwan, assistant executive officer. California law was changed in 1984 to allow the state's public pension plans to invest in leveraged buy-outs.

"We've heard from so many LBO firms for so long," Mr. Schwan said. "All of them (say they) have a different angle and all have a niche," he said. "We've essentially said 'no' to all of them."

Mr. Schwan said, however, a committee will seek to "define with considerable precision" policy guidelines for potential leveraged buy-out investments. The guidelines will be presented to the investment board in January. He added that, if given the go-ahead, any investment likely would be considered part of the alternative investment group, which includes venture capital. The system has targeted 10% of its assets to alternative investments.

The guidelines, Mr. Schwan said, likely would include a preference for a firm with a proven track record, and also the state's prohibition against investing in South Africa-related companies. He also repeated the refrain of other public fund investors in leveraged buy-out funds: "We would not want to be involved in a hostile takeover."

The refrain is one that has taken on particular import since Kohlberg Kravis Roberts & Co.'s unsolicited $20.3 billion bid for RJR Nabisco. KKR invests the assets of many public funds.

Although many of the public plan investors say they don't perceive the KKR bid as hostile because the company's management first put the company into play, not all agree.

"Up until the RJR bid, people hadn't thought there was a gray area between hostile and friendly takeovers," Mr. Schwan said. "We're certainly going to give that area a lot of thought."

The Massachusetts Pension Reserve Investment Management Board, unhappy with the perceived hostile nature of the KKR offer, won't allow any of its $29.3 million outstanding commitment to the KKR fund to be used in the bid, if it is successful. PRIM used its prohibition of South Africa investments as the reason for its decision, even though it had gotten around the ban during the 1986 KKR-led buy-out of Beatrice Cos.

Leveraged buy-outs, even if friendly, draw more attention when the buy-out is of a company from one's home state.

The Oregon Public Employes Retirement System faced that issue in 1981, when it invested $178 million in the KKR fund that bought out Oregon-based Fred Meyer Inc.

James George, Oregon investment manager, said the initial public outcry over the feared results died down when the board agreed to the buy-out and Fred Meyer came to employ more people after the leveraged buy-out than it had before. ■

Foreign

Continued from page 32

While actual funding won't start until a global custodian is chosen, the fund has picked Parametric Portfolio Associates Inc., Seattle, to run 4% of the assets in an equity index fund based on the Salomon/Russell Broad Market Index; SBC Portfolio Management International Inc., New York; and WorldInvest Ltd., London, to run active equity portfolios at 2% each, and Dimensional Fund Advisors Inc., Santa Monica, Calif., to run 1% in an international small-cap index fund.

Many major public funds, however, still are making their first moves into the international arena.

The $7.2 billion Colorado Public Employees' Retirement System, Denver, went to 12% invested overseas this year from nothing.

Also, three of the five systems comprising the $30 billion New York City Retirement Systems have just announced their first hires. The $1.83 billion New York City Fire Department Pension Fund will invest up to 3% — about $55 million — of its assets in a South Africa-free international index fund based on the Morgan Stanley Capital International Europe Australia Far East Index. State Street Bank and Trust Co., Boston, will manage the portfolio.

The $15 billion New York City Employees' Retirement System and the $6 billion New York City Police Pension Fund each has hired Rowe Price-Fleming International Inc., London to run $150 million and $60 million, respectively, in international fixed-income accounts (*P&I Age*, Oct. 31).

The system is allowed under state law to place up to 7.5% of assets in international. Each of the respective systems will invest about 4% in international equity and bond index funds, while another 3.5% will be invested in active strategies in about a year, said Beverly Hamilton, third deputy comptroller.

In its first international hire, the $1.5 billion Maine State Retirement System, Augusta, just hired Bankers Trust Co. — Investment Management Group, New York, to run $30 million in an EAFE index fund, said Claude Perrier, executive director.

Wilshire Associates was the consultant.

Other public funds considering their first forays into international include the California State Teachers' Retirement System, Sacramento; Public Employees' Retirement System of Mississippi, Jackson; the Teachers' Insurance & Retirement Fund of North Dakota, Bismarck; and the Fresno (Calif.) County Employees' Retirement System.

Several others lack any international investments.

The New Jersey Division of Investment, Trenton, with $20 billion in pension assets, is looking at creating an international exposure, but has to overcome several legal hurdles, including a state law requiring use of a custodian whose principal offices are in New Jersey, said Roland Machold, director. ■

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CHASE INVESTORS

GIC activity

Continued from page 3

keep it at a manageable level. I don't see it as an unhealthy trend. I don't see things going to hell in a handbasket if they are prudent in their use of junk bonds," Mr. Bowles said.

In addition to having to buy more "junk" bonds, deterioration of a bond's quality is a concern.

"It is one thing to buy junk bonds and quite another to have a high-quality bond and then see it decline precipitously in price" after the company undergoes a leveraged buy-out, said Milton Meigs, senior insurance analyst at Duff & Phelps Inc., Chicago.

"I don't think the current state of LBOs is significantly changing the credit quality of the insurance business," he said. "But it continues the trend generally of decreasing the quality of their portfolios.

"The asset quality issue has yet to be put to the test of a deep recession, but there can be little doubt that as an issuer's asset quality decreases there is a diminution of the insurer's credit quality generally. Those that defend the increasing use of lower quality assets claim the higher yields, combined with diversification, more than make up for the additional risk."

According to a recent report by Moody's Investors Service Inc., New York, the use of junk bonds by insurance companies has increased dramatically since 1983 and 1984 when the average among 36 major carriers was only about 6%. Junk bonds increased to 7% of portfolios in 1985, 9.23% in 1986 and 11.4% in 1987.

Judith Markland, vice president-group pension guaranteed product services at John Hancock Mutual Life Insurance Co., Boston, pointed out most major insurance carriers rely on the private placement market for investments and are not deeply involved in public bond markets.

"Private placements tend to preclude this buy-out surge," Ms. Markland said. "But no market is that neat, clean and tidy. Every time something like this happens the tendency of the market is to perceive a credit problem. What has happened is that quality spreads have narrowed ... and some higher-rated securities are being perceived as more risky."

She said private placements do yield less than the public bond markets because of the higher-quality paper.

"If you are a GIC investor, you must determine whether you are buying the credit of the carrier or of the carrier's portfolio and assess an insurer's financial sophistication and ability to manage the risks in both the asset and liability portfolios."

She said GIC issuers must analyze default risk because high-yield, low-quality investments can boost GIC rates and appear more attractive. It is important the insurance company deduct a realistic estimate of default from the higher income earned on riskier investments.

Low-quality investments also require the insurance company to have more equity capital invested in the business because default risk tends to be cyclical. The additional earnings to support the additional capital investment must also be deducted from the bond rate.

Several Wall Street analysts and financial experts have reported recently on the risks associated with holding public debt.

Salomon Brothers Inc., New York, in a Nov. 2 memorandum to portfolio managers noted "seasoned senior public debtholders of investment-grade issues face considerable price drops and default risk when the underlying shareholders' interests are served ahead of the bondholders'.

"Bondholders of companies such as Allied Stores, American Standard, Federated Department Stores, Freuhauf and USG suffered significant price and severe credit deterioration following the leveraged restructurings of these companies' balance sheets."

Most GIC managers, however, claim they are not concerned about the effect of leveraged buy-outs and the increased use of junk bonds on insurers' portfolios.

Alan Kominz, president of Kominz Co., a GIC management firm in Playa del Rey, Calif., said buy-outs won't hurt insurance companies because "usually they don't own a large enough piece (in a takeover candidate) that it will hurt them."

Charles Golden Jr., vice president at State Street Bank and Trust Co., Boston, said, "While almost any company could become a buy-out target, insurance companies look at the increased risk and are seeking higher premiums for assuming the additional risk, which means higher profits for the insurance companies or higher GIC rates." ■

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*CDA Investment Technologies, Inc. Rank among 936 managers.
Past performance is not necessarily an indication of future returns.

Issues remain

Continued from page 3

oco Products Co., Ms. Andersen said. The resolutions ask the companies to adopt the principles.

Connecticut has not filed resolutions with the other five companies either because it has not held the stock more than a year to be eligible to submit resolutions or because the companies also have operations in South Africa and must be divested anyway under state law, Ms. Andersen said.

Shareholders are addressing several other social and political issues. The Interfaith Center on Corporate Responsibility, which coordinates shareholder actions for more than 200 religious organizations, is calling for major banks — including Bankers Trust Co., J.P. Morgan & Co. Inc. and BankAmerica Corp. — to cut off loans to Chile.

It also has filed resolutions with RJR Nabisco Inc. and Philip Morris Inc., seeking the appointment of scientific committees to study the effects of smoking. "We're challenging the companies to prove their argument that smoking causes no ill effects," said Tim Smith, executive director of the center.

Common Cause, a lobbying group that has not sponsored shareholder resolutions previously, this year has filed them with 10 companies, asking them to report on their political action committee expenditures and to take steps to limit these outlays. Common Cause has unsuccessfully sought legislation to curb PAC spending, Ms. Mathiasen said.

Common Cause does not hold stock, but is able to sponsor the resolutions because individual members are shareholders in some corporations, she said. Companies receiving the resolutions are Aetna Life & Casualty Co.; American Express Co.; Citicorp; General Electric Co.; GM; Minnesota Mining & Manufacturing Co.; Mobil Corp.; Pfizer Inc.; Unisys Corp.; and BankAmerica.

Another first-time resolution sponsor is the Federation of American Scientists, which is sponsoring resolutions to urge major lenders to Argentina and Brazil to pressure leaders of those countries to endorse nuclear non-proliferation, Ms. Mathiasen said. The three bank receiving the resolutions are Citicorp, BankAmerica and Manufacturers Hanover Corp.

People for the Ethical Treatment of Animals, which sponsored resolutions on animal testing at eight corporations in 1988, likely will resubmit these, Ms. Mathiasen said.

Although dissident shareholder resolutions almost never receive a majority of shares voted, their sponsors continue to see value in submitting them.

"Even if a resolution is not successful, it is part of a process of educating corporate management, shareholders and the media about our issues," said Steve Mathews, assistant New York City controller. The $30 billion New York City retirement systems are sponsoring or co-sponsoring 21 resolutions each on Northern Ireland and South Africa this year. ■

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Insurer assets

Continued from page 1

billion in assets, according to Dick Klipstein, vice president. He said those insurers represented a total $150 billion in assets ripe to be invested by money mangers.

Walter Blasberg, senior vice president of CIC Asset Management Corp., an investment affiliate of The Continental Insurance Co., New York, estimates there was $90 billion in potential assets to be managed for the property and casualty industry alone in 1985.

That estimate is low, according to others. Dick Press, senior vice president and principal of Chicago-based Stein, Rowe & Farnham Inc., estimates the property and casualty market at $103 billion, while the life and health market is another potential $115 billion.

Others, such as Rick Lieb, senior vice president of SEI Corp., Wayne, Pa., estimate the potential market at $500 billion to $1 trillion. "There are 700 insurance companies that I would consider in our core market, each with between $25 million to $2 billion in assets," Mr. Lieb said.

But whatever the size of the market, investment industry experts are scrambling for — and expanding their efforts to reach — it, and the competition is fierce.

"You have banks, insurance companies, brokerage firms, investment managers" competing for the market, Aetna Financial's Mr. Klipstein said. "The array is unbelievable." He said about 100 money managers have contacted the same 500 insurers his firm is courting.

Aetna decided two years ago to look at managing other insurers' assets after being approached numerous times in the past decade, Mr. Klipstein said. After researching the potential market, he said, the decision was made in March to tackle the market. Aetna Financial now manages $1.1 billion in other insurers' assets.

The Scudder Insurance Asset Management Group ("SIAM) was formed in 1980 as a separate division of Scudder, Stevens & Clark, New York. Beginning with $1.7 billion it transferred from Scudder, SIAM has grown to about $10 billion in insurance assets managed, according to David Watts, managing director. He said SIAM targets insurance companies with between $10 million and $1 billion in assets.

Asset Allocation and Management Cos., Chicago, focuses solely on insurance company assets. Andrew Jarmel, chief executive officer for Asset Allocation, said the company was formed in 1982, and manages $3 billion.

"What we've seen recently is that several of the big insurance companies have spun off their investment departments," he said. "The problem for the investors is: Who wants another insurance company looking over your shoulder?"

Jeffrey Winter, director of marketing for MIMLIC Asset Management Co., Minneapolis, a subsidiary of The Minnesota Mutual Life Insurance Co., argues insurance subsidiaries have a "decided advantage" when it comes to managing insurance company assets.

"We are totally conversant in the field and recognize the ramifications of all investment decisions," he said. MIMLIC manages $400 million in outside insurance company assets.

Despite the competition, the managers agree investment decisions for insurer assets are more complicated than for pension management.

"One of the critical factors in managing insurance company assets is a fundamental understanding of insurance accounting," said Michael Witte, vice president of Chancellor Capital Management, New York, with $2.1 billion in insurance company assets. "You've got to appreciate the impact of active management on the financial health of an insurance company," he said. "There are a lot more things to input into the buy-sell decision."

Stein Rowe's Mr. Press said while pension fund investing is based on actuarial studies and derived targets, "all rather coldbloodedly quantitative factors," insurance investing depends on several "qualitative" factors.

Included among those are whether the company is a start-up or mature, what lines of insurance it is entering or leaving, whether it will be profitable from year-to-year, and the importance of its investment income.

"The investment manager has to consider himself a member of the company's senior management," Mr. Press said.

The nature of the insurer — "long-tail" (riskier, such as medical malpractice) vs. "short-tail" (predictable payouts, such as auto and fire losses) — also poses a major consideration, according to CIC's Mr. Blasberg, because they determine liability duration.

The bottom line, according to Mr. Blagden of Brown Brothers, is that, because of state regulation, the amount of a company's surplus affects its ability to write policies.

He said most start-up companies are likely to have portfolios "overwhelmingly, if not entirely" invested in fixed income. Because most fixed income can be carried at cost, it has less fluctuation on the company's surplus, he said. More mature insurance companies will be able to invest more in the equity market, he said.

Mr. Kirk said Babson's investment strategy is to invest, with low turnover, in high-quality equity, and Stein Rowe's Mr. Press said the firm has developed convertible bond portfolios to allow insurers the ability to carry the investment at cost and to participate in the equity market.

Developments of the 1980s, including volatile bond markets, poor underwriting returns, falling interest rates and tax reform have heightened the importance of investment income.

"The investment side has always been as important as underwriting, but the recognition of that is a more recent phenomenon," Chancellor's Mr. Witte said.

"No longer are investments considered an orphan."

For example, while the 1986 Tax Reform Act cut the corporate tax rate, its other amendments hurt the insurance industry, according to CIC's Mr. Blasberg. He estimates those revisions — including discounting the deductibility of loss reserves, adding a portion of unearned premium reserves to taxable income and taxing a portion of previously tax-exempt insurer income — could reduce insurance company profits by as much as 20%.

"There are two ways to cover that potential loss — raise prices, which is difficult, or try to get more out of investment dollars," he said.

Mr. Jarmel of Asset Allocation said a usual 2.5-year down cycle in underwriting has stretched to eight years in the 1980s, largely because of interest-rate fluctuations that have spawned a whole array of interest-rate sensitive products.

According to Mr. Witte, the development of these interest-rate sensitive products has a direct effect on the traditional buy-and-hold investment strategy.

"When everyone was selling whole or term life insurance, it didn't take any genius to invest for 30 years," he said.

All the variables pose a problem for the consultants who are expanding into this area.

"I'm concerned that some consultants, having identified this area as a rapidly growing market, may not make the effort to understand what is important in selecting an insurance company portfolio manager," Mr. Press said. "It's not just the bottom line — it is not just a quantification contest," Mr. Press said. "The qualitative aspects are the essential ingredient."

Acknowledges SEI's Mr. Lieb: "When you are a pension fund, you don't have tax complications. Insurance tends to be a regulated financial service industry, harder to understand, harder to evaluate," he said. "You've got to make sure you are measuring apples to apples."

The differing investment objectives make establishing a data base hard, according to Phillips Babcock, senior vice president at Callan Associates Inc. in New York.

Robert Penter, a consultant with Hewitt Associates, Lincolnshire, Ill., said the different financial structures of insurance companies and thus their different investment strategies and needs make it hard to create a standardized measure.

"In the pension industry, we all have our universes," he said. "It's almost meaningless in the insurance industry."

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